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IN THE

Supreme Court of the United States

October Term , 1996

Public Service Commission of the
State of New York, *et al.*,
Petitioners,

v.

Federal Energy Regulatory Commission and
United States of America
Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Has the Federal Energy Regulatory Commission exceeded its authority to regulate the interstate transportation of natural gas under Sections 1(b) and 1(c) of the Natural Gas Act, 15 U.S.C. § 717(b) and (c), by preempting state authority to regulate how local gas distribution companies resell or assign their pipeline capacity rights to retail customers?

PARTIES TO THE PROCEEDING BELOW

Federal Energy Regulatory Commission (Respondent)
Alabama Gas Corporation (Intervenor)
Algonquin Gas Transmission Company (Intervenor)
Allied Signal Inc. (Intervenor)
American Forest & Paper Association (Petitioner)
American Public Gas Association (Petitioner)
Amoco Production Company (Intervenor)
Anadarko Petroleum Corporation (Intervenor)
ANR Pipeline Company (Intervenor)
Arcadian Fertilizer (Petitioner)
Arco Natural Gas Marketing (Intervenor)
Arco Oil & Gas Company (Intervenor)
Arizona Electric Power Cooperative Inc. (Petitioner)
Arizona Public Service Company, *et al.* (Petitioner)
Asarco, Inc., Cyprus Miami Mining Corporation, and Magma Copper Company (Petitioner)
Associated Gas Distributors (Petitioner)
Associated Natural Gas Company (Petitioner)
Atlanta Gas Light Company (Petitioner)
Baltimore Gas & Electric Company (Petitioner)
Bay State Gas Company, *et al.* (Intervenor)
Board of Water, Gas & Light Commissioners, Albany, Georgia (Intervenor)
Brooklyn Union Gas Company (Intervenor)
Canadian Association of Petroleum Producers, *et al.* (Intervenor)
Carnegie Natural Gas Company (Petitioner)
Chattanooga Gas Company (Petitioner)
Cascade Natural Gas Corporation (Intervenor)
Chevron, U.S.A., Inc. (Intervenor)
Cincinnati Gas & Electric Company, *et al.* (Intervenor)
Citizens Gas & Coke Utility (Petitioner)
City of Hamilton, Ohio (Petitioner)
CNG Transmission Corporation (Petitioner)
Colorado Interstate Gas Company (Petitioner)

Colorado Springs Utilities (Petitioner)
Columbia Gas Distribution Companies (Intervenor)
Columbia Gas Transmission Corporation (Intervenor)
Conoco, Inc. (Intervenor)
Consolidated Edison Company of New York, Inc. (Petitioner)
Dakota Gasification Company (Intervenor)
Dayton Power & Light Company (Intervenor)
Destec Energy, Inc. (Intervenor)
East Ohio Gas Company, *et al.* (Intervenor)
East Tennessee Group (Petitioner)
East Tennessee Natural Gas Company (Intervenor)
Elizabethtown Gas Company, an Operating Division of NUI Corporation (Petitioner)
El Paso Natural Gas Company (Intervenor)
Enron Oil & Gas Marketing, Inc. (Intervenor)
Enserch Development Corporation (Petitioner)
Equitrans, Inc. (Petitioner)
Exxon Corporation (Intervenor)
Florida Cities (Intervenor)
Florida Gas Transmission Co. (Intervenor)
Foothills Pipelines Ltd. (Intervenor)
Fort Pierce Utilities Authority and the City of Vero Beach, Florida (Intervenor)
Fuel Managers Association (Intervenor)
Georgia Industrial Group (Petitioner)
Great Lakes Transmission Ltd. (Intervenor)
Hadson Gas Systems, Inc. (Petitioner)
Illinois Commerce Commission (Petitioner)
Illinois Power Company (Petitioner)
Indiana Gas Company (Petitioner)
Interstate Natural Gas Association of America (Intervenor)
Joint State Commissions and Consumer Advocates (Petitioner)
KN Energy, Inc. (Intervenor)
Kern River Gas Transmission Company (Petitioner)

Koch Gateway Pipeline Company (Petitioner)
Laclede Gas Company (Petitioner)
Long Island Lighting Company (Petitioner)
Louisville Gas & Electric Company (Petitioner)
Maryland Office of People's Counsel (Petitioner)
Maxus Exploration Company and Maxus Gas Marketing Company (Intervenor)
Memphis Light, Gas and Water Division (Petitioner)
Meridian Oil Inc. (Petitioner)
Michigan Consolidated Gas Company (Intervenor)
Midland Cogeneration Venture Limited (Petitioner)
Minnesota Public Utility Commission and Minnesota Department of Public Service (Intervenor)
Mississippi River Transmission Corporation (Intervenor)
Missouri and Kansas Gas Users (Intervenor)
Missouri Public Service Commission, *et al.* (Petitioner)
Mitchell Energy Corporation (Intervenor)
Mobile Gas Service Corporation, *et al.* (Intervenor)
Mobile Natural Gas, Inc. (Intervenor)
Montana Public Service Commission, Public Utilities Commission of South Dakota and Montana Consumer Counsel (Petitioner)
Mountaineer Gas Company (Petitioner)
National Association of State Utility Consumer Advocates (Petitioner)
National Association of Gas Consumers (Intervenor)
National Fuel Gas Supply Corporation (Intervenor)
Natural Gas Clearinghouse (Intervenor)
Natural Gas Pipeline Company of America (Intervenor)
New Jersey Board of Regulatory Commissioners (Petitioner)
New Jersey Natural Gas Company (Petitioner)
New York State Electric & Gas Corporation (Intervenor)
New England Power Company (Petitioner)

Northern Indiana Public Service Company (Petitioner)
Niagara Mohawk Power Corporation (Petitioner)
NorAm Energy Corporation (Petitioner)
North Carolina Natural Gas Company and Public Service Commission of North Carolina (Intervenor)
Northeast Energy Associates and New Jersey Energy Associates (Intervenor)
Northern Border Pipeline Company (Intervenor)
Northern Distributor Group (Intervenor)
Northern States Power Company (Minn.), *et al.* (Intervenor)
Northern Natural Gas Company, *et al* (Intervenor)
Northwest Alaskan Pipeline Company (Petitioner)
Ocean State Power, *et al.* (Petitioner)
Office of the Consumers' Counsel, State of Ohio (Petitioner)
Orange and Rockland Utilities, Inc. (Petitioner)
Ozark Gas Transmission System (Petitioner)
Pacific Gas & Electric Company (Petitioner)
Pacific Interstate Transmission Company, *et al.* (Intervenor)
Pan-Alberta Gas, Ltd. (Intervenor)
Panhandle Customer Group (Intervenor)
Panhandle Eastern Pipe Line Company (Intervenor)
Panhandle Trading Company (Intervenor)
Pennzoil Exploration & Production Company and Pennzoil Gas Marketing Company (Intervenor)
PEPCO Energy (Petitioner)
Pennsylvania Office of Consumer Advocate (Petitioner)
Pennsylvania Public Utility Commission, *et al.* (Petitioner)
Peoples Gas System, Inc. (Intervenor)
Peoples Natural Gas Company (Petitioner)
Piedmont Natural Gas Company (Petitioner)
Philadelphia Electric Company (Petitioner)
Phillips Petroleum Company, *et al.* (Intervenor)

Plains Petroleum Operating Company (Petitioner)
Process Gas Consumers Group, *et al.* (Intervenor)
Producer-Marketing Transportation Group (Petitioner)
ProGas, Ltd. (Petitioner)
Public Service Commission of the Commonwealth of Kentucky (Petitioner)
Public Service Commission of Nevada (Intervenor)
Public Service Commission of the State of New York (Petitioner)
Public Service Commission of West Virginia, Consumer Advocate Division (Petitioner)
Public Service Commission of Wisconsin (Petitioner)
Public Service Electric & Gas Company (Intervenor)
Public Utilities Commission of the State of California (Petitioner)
Rochester Gas & Electric Company (Intervenor)
Shell Gas Trading Company (Intervenor)
South Jersey Gas Company (Intervenor)
South Carolina Pipeline Corporation (Intervenor)
Southern Natural Gas Company (Intervenor)
Southwest Gas Corporation (Petitioner)
State of Louisiana (Petitioner)
State of Indiana, Office of Utility Consumer Counselor (Petitioner)
Tenneco Gas, Inc. (Intervenor)
Tennessee Gas Pipeline Company (Intervenor)
Tennessee Small General Service and Columbia Small Customer Group (Intervenor)
Tennessee Valley Municipal Gas Association (Petitioner)
Texaco, Inc. (Intervenor)
Texas Eastern Transmission Corporation, *et al.* (Intervenor)
TransCanada Pipelines Limited (Intervenor)
Transcontinental Gas Pipe Line Corporation (Intervenor)
Transwestern Pipeline Company (Intervenor)

Trunkline Gas Company (Intervenor)
T.W. Phillips Gas & Oil Company (Intervenor)
UGI Utilities, Inc. (Intervenor)
Union Pacific Fuels, Inc. (Intervenor)
United Cities Gas Company (Intervenor)
United Distribution Companies (Petitioner)
Vaster Resources, Inc. and Vaster Gas Marketing, Inc. (Intervenor)
Virginia Electric & Power Company (Petitioner)
Washington Gas Light Company (Intervenor)
Williams Gas Marketing Company (Petitioner)
Williams Natural Gas Company (Petitioner)
Williston Basin Interstate Pipeline Company (Petitioner)
Windward Energy and Marketing Company (Intervenor)
Wisconsin Distributor Group (Petitioner)

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Public Service Commission of the
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PETITION FOR WRIT OF CERTIORARI

Petitioners Public Service Commission of the State of New York, Pennsylvania Public Utility Commission, Maryland Office of People's Counsel, Missouri Public Service Commission, National Association of Regulatory Utility Commissioners, and New Jersey Board of Public Utilities petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit ("Court of Appeals") in this case.

I. OPINIONS BELOW

The opinion of the Court of Appeals is reported at 88 F.3d 1105 (D.C. Cir. 1996) (Pet. App. 1a-174a).[1] The Federal Energy Regulatory Commission's ("FERC") decision Order 636, is reported at F.E.R.C. *Stats. & Regs.* (CCH) ¶ 30,939 (Pet. App. 175a-407a). Order No. 636-A denying petitioners' timely applications for rehearing is reported at F.E.R.C. *Stats. & Regs.* (CCH) ¶ 30,950 (Pet. App. 408a-812a).

II. JURSIDICTION

The Court of Appeals entered judgement on July 16, 1996 and denied rehearing on October 29, 1996. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

III. STATUTES INVOLVED

The relevant provisions of the Natural Gas Act are reproduced at Pet. App. 1007a-1025a.

IV. STATEMENT OF THE CASE

This case presents an important, recurring issue of federal law relating to the statutory line delineating federal and state jurisdiction over the natural gas industry. That line has been respected for over 50 years as permitting state regulation of local distribution company ("LDC")

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[1] An appendix containing the opinion of the Court of Appeals and its opinions on rehearing, as well as the several lengthy FERC orders that give rise to those opinions, is being filed jointly by the several petitioners for writ of certiorari of the Court of Appeals' decision.

transactions with their retail customers ("end-users") in the individual states. In the orders below, FERC asserted exclusive jurisdiction over such transactions. FERC's usurpation of jurisdiction not only upsets the regulatory balance established by Congress, but also creates unreasonable impediments to state regulatory initiatives designed to increase gas purchasing options for ultimate consumers. The likely losers from FERC usurpation would be small retail users who would be unable to partake in the competitive advantages associated with state regulatory initiatives to unbundle natural gas service into separate components.

A. Regulatory Background

The Natural Gas Act ("NGA") created the Federal Power Commission (now FERC) to govern sales for resale in interstate commerce, interstate transportation of gas, and the companies engaged in such transportation or sales. 15 U.S.C. § 717(b) ("NGA Section 1(b)"). This federal authority filled the gap precluding state regulation of interstate transportation and wholesale sales of natural gas. *See generally Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377-80 (1983).

The NGA does not apply, however, "to the local distribution of natural gas or to the facilities used for such distribution." NGA Section 1(b).[2] Under the NGA, existing state authority continues over transactions between LDCs

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[2] Congress later passed the so-called "Hinshaw exemption," 15 U.S.C. § 717(c), which expanded the scope of entities and facilities exempt from federal regulation. Of note for the instant matter, the exemption explicitly reconfirmed the primacy of state regulatory authority: "The matters exempted from the provisions of this Act . . . are hereby declared to be matters primarily of local concern and subject to regulation by the several States." *Id.*

and their customers, while federal authority fills in the gaps state regulation cannot reach:

> The Act, though extending federal regulation, had no purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous regard to the continued exercise of state power, not to handicap or dilute it in any way.

Panhandle Eastern Pipeline Co. v. Public Serv. Comm'n, 332 U.S. 507, 517-18 (1947).

The NGA thus contemplates two separate and distinct areas of regulatory authority: federal regulation over interstate pipeline transactions with LDCs and others and state regulation over LDC transactions with their customers.

B. FERC's "Unbundling" Policies

The FERC orders below continue the process of "unbundling" services offered by interstate pipelines. Historically, pipelines provided natural gas on a "bundled" merchant basis under which natural gas and all related services (production, gathering, transportation, and storage) were sold in a unitary package offered for a single price. LDCs, in turn, packaged the bundled pipeline service along with the LDCs' own local distribution service into a unitary product for a single price. Under this industry structure, which remained in effect for more than 50 years, FERC regulated the price, terms, and conditions of bundled pipeline sales to LDCs and the states regulated the price, terms, and conditions of the LDC sales of bundled services to retail end-users.

Mandatory unbundling at the federal level requires pipelines to disaggregate their merchant service into its individual components, each of which is offered and priced separately. Customers are free to seek competitive alternatives by purchasing natural gas supplies, gathering, transportation, and storage services separately from different providers.

Many states currently have under consideration, and some have implemented, initiatives which allow retail access to unbundled LDC services. In order to effectuate retail access, which typically involves purchasing natural gas in a state other than where the gas is consumed, retail consumers need assurance that they can transport their purchased gas not only through the LDC's distribution system but also through LDC-owned interstate pipeline "capacity," including storage (i.e., rights in the space needed to move gas and store it from the selling point to the distribution point). Customer use of LDCs' pipeline capacity is known as "capacity release."

LDCs purchased pipeline capacity rights under long-term contracts, virtually all of which were executed prior to federal unbundling and which cannot be terminated unilaterally. States have always regulated LDCs' allocation and repricing of such capacity in the context of state regulation of bundled sales because the cost of pipeline capacity was included in the LDCs' retail rates. When unbundling and retail access initiatives are implemented by LDCs pursuant to state-approved restructuring programs, and end-users choose to purchase their gas from alternate suppliers, LDCs may no longer need all of their purchased pipeline capacity to serve their merchant function. But this capacity in many cases provides the only means by which an LDC's customer can transport purchased gas supplies. "Capacity release" is the means by which LDCs transfer

temporary use of their pipeline capacity for transportation of purchased gas by their customers.

At first, FERC-approved pipeline tariffs contained capacity release provisions under which LDCs could negotiate terms for the release to their end-use customers, subject to state regulation. In the rulings at issue, FERC switched position and established rules governing the LDCs' release of capacity to their customers. As a result, all capacity release was subjected to FERC's overall plan requiring LDCs to release their capacity rights to the highest bidder up to a maximum rate, including bidders outside an LDC's service area. Under the new FERC rules, the successful bidders must then execute contracts with the interstate pipeline.

These requirements create unreasonable impediments to state regulatory initiatives intended to provide retail consumers with increased competitive opportunities. The FERC bidding process creates uncertainties as to whether in-state end-users will obtain access to their LDC's pipeline capacity rights. The obligation for end-users to execute separate contracts with the interstate pipeline creates unnecessary administrative burdens particularly where LDCs have numerous pipeline transportation and storage contracts which must be allocated to end-users. The uncertainty caused by FERC's program will impede and could discourage efforts to create successful unbundling programs at the state level among consumers.

C. Earlier Proceedings On The Same Question

Prior to the rulings at issue, FERC had allowed LDC capacity release through private transactions as part of FERC's open access policy. Under the prior FERC program, capacity release provisions were included in FERC-approved individual pipeline tariffs. These FERC-approved provisions

set the ground rules for LDCs to arrange for the release of their capacity to their customers. *See generally, e.g., Texas Eastern Transmission Corp.*, 48 F.E.R.C. (CCH) ¶ 61,248, *order on reh'g*, 48 F.E.R.C. (CCH) ¶ 61,378 (1989), *order on reh'g*, 51 F.E.R.C. (CCH) ¶ 61,170, *order on reh'g*, 52 F.E.R.C. (CCH) ¶ 61,273 (1990) (orders approving tariff provisions for capacity release).

Importantly, FERC recognized that capacity purchased by LDCs in interstate pipeline facilities should be treated as the LDCs' (not the pipelines') own capacity. *See Texas Eastern*, 48 F.E.R.C. (CCH) ¶ 61,378 at p. 62,552 ("[an LDC's] right to capacity on [a pipeline's] system may be considered an expansion of [the LDC's] system . . . ."). This recognition acknowledged the reality that LDCs could not offer distribution and retail sales services without having the wherewithal to transport gas over pipeline facilities that connect production fields and the LDCs' distribution systems.

FERC controlled the interstate aspect of the prior capacity release program by setting the ground rules in approved pipeline tariffs. Pet. App. at 73a and cases cited therein. Tariff terms allowing capacity release sought to maximize opportunities for private transactions. *E.g., Texas Eastern*, 48 F.E.R.C. (CCH) ¶ 61,248 (1989). Subject to FERC policy and FERC-approved tariff provisions, capacity release "transactions occurred directly and privately between shippers." Pet. App. at 74a. As a result, capacity release took "place directly between the two parties, and the replacement shipper [e.g., end-user] essentially stepped into the shoes of the releasing shipper [i.e., LDC]." *Id.* at 73a.

On the state level, LDCs remain subject to statutory public service obligations to provide service to all firm customers. Since LDCs purchased firm capacity to fulfill these obligations, they cannot release capacity without state

approval. Thus, while FERC policy and tariffs created the opportunity for the LDCs' release of their pipeline capacity, any release between an LDC and its end-users is subject to state jurisdiction.

This earlier FERC plan operated within the historical dual jurisdiction established by the Natural Gas Act. FERC set national policy for release of pipeline capacity by implementing its policy objectives into approved pipeline tariffs. Within the tariff limits, states were free to establish regulations to govern capacity release transactions between LDCs and their end-users based on local needs as perceived by the States.

D. The Decisions Below

In the rulings at issue, FERC asserted exclusive jurisdiction over the price and terms of the release of capacity by LDCs to their end-users. Under the new FERC rules, capacity must be released to the highest bidder (subject to a pricing cap), even if that bidder is not a customer within an LDC's service territory. To create the appearance of a colorable claim for federal jurisdiction, administration of pre-existing capacity assignment rules were changed in two respects. First, rather than continuing capacity release as a matter between private parties,[3] FERC instituted a "uniform national 'capacity release' program." Pet. App. at 74a. Despite FERC's claim that capacity release "requires the central involvement of the pipeline in the transaction," *Id.*, earlier capacity release transactions had been successfully consummated without pipeline involvement.

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[3] This approach accepts the contractual reality that LDCs retain all rights and obligations related to the released capacity. For example, LDCs remain liable to pay reservation fees for their released capacity in the event that a replacement shipper defaults.

E. The Court of Appeals' Affirmance

Affirmance of FERC's new policy was based on a reading of the NGA that gives primacy to federal regulation, not to state regulation as Congress intended. This reading allows, in effect, the tail to wag the dog by assuming that if any interstate component can be found in the underlying transaction, then federal jurisdiction applies.

The Court of Appeals reads the NGA Section 1(b) exemption for "the local distribution of natural gas" as "added to the Act merely for clarification and was not intended to deprive [FERC] of any jurisdiction otherwise granted by § 1(b)." Pet. App. at 78a (citation omitted). This ignores the fact that the same paragraph of the legislative history on which reliance is placed also states that the "local distribution" language was retained in NGA Section 1(b) to avoid "the contention, however unfounded, that the elimination of [the exemption] would broaden the scope of the act." H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937). Thus, even if the local distribution exemption could be read out of the NGA as "surplusage," Pet. App. at 78a, its elimination would not broaden federal jurisdiction.

The Court of Appeals also looked to the "high pressure pipe line" and "low pressure distribution" distinction that had once identified the boundary between federal and state authority for constitutional purposes. *Id.* The usefulness of such an analysis "based on supposedly precise division between 'direct' and 'indirect' effects on interstate commerce" has been called into question by "the general trend in our modern Commerce Clause jurisprudence to look in every case to 'the nature of the state regulation involved, the objective of the state, and the effect of the regulation on the national interest in the commerce.'" *Arkansas Elec. Coop.*, 461 U.S. at 390 (citation omitted).

From these starting points, the Court of Appeals "viewed distribution as confined to its parceling out function and (probably) even more narrowly, to parceling out *accompanied by* retail sales." Pet. App. at 79a. (citation omitted). On the question of LDC capacity release to LDCs' own end-users, the Court of Appeals followed the logic of its view by concluding that "States have been -- and are still -- permitted to regulate LDCs' bundled sales of natural gas to end-users because those transactions include transportation over local mains and the retail sale of gas," but where unbundling occurs, "FERC retains jurisdiction over *the interstate transportation component*," including capacity release. *Id.* at 82a.

The Court did not consider States' interests in controlling transactions (including capacity release) between LDCs and their customers, a matter that has always been subject to State regulation.[4]

V. REASONS FOR GRANTING THE WRIT

The decisions below override the clear intent of Congress to maintain States' authority over local matters between LDCs and their own customers. Use of pipeline capacity by LDCs to transport gas is an integral part of the service that LDCs provide to their customers. Such service is subject to rate regulation by the States as part of their authority over transactions between LDCs and their customers. The decisions below create a new policy that artificially interjects pipelines into this process as a means to

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[4] The Court dismissed NGA Section 1(c), the Hinshaw exemption, on the same theory that facial federal authority over interstate transportation is sufficient to override historical state jurisdiction over the underlying transaction. *Id.* at 82a. The Court never considered the scope or purpose of the Section 1(c) exemption, or the importance of state regulation in this matter.

expand federal jurisdiction beyond that allowed by the NGA. Such usurpation of authority by FERC cannot be allowed to stand.

A. The NGA Establishes That State Authority Takes Primacy In Delineating The Boundaries Of State And Federal Authority

The scope of the NGA's preemptive intent can be determined only after consideration of the historical context in which the NGA was enacted. Congress was, of course, aware of the state regulatory activity in the natural gas field prior to passage of the NGA. Any intent to preempt that state regulatory authority must be expressed in "direct and unambiguous language;" without clear, direct language, Congressional intent to preempt should not be inferred. *New York State Dept. of Social Services v. Dublino*, 413 U.S. 405, 414 (1973).

Strong reasons for not inferring preemption apply in "field[s] which the States have traditionally occupied." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Prior to the NGA, there was no federal regulation of natural gas sales. All regulation of such sales was done at the State level. Indeed, the NGA was enacted to fill the gaps in regulatory authority where the States were precluded from acting under the dormant Commerce Clause, as the Court of Appeals noted. Pet. App. at 81a. Thus, it is clear that Congress did not intend the NGA to occupy the entire field, but rather left to the States those areas which they had historically controlled. *See Panhandle Eastern*, 332 U.S. at 519 ("Congress, it is true, occupied a field. But it was meticulous to take in only territory which this Court has held the states could not reach."); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1941) (NGA "take[s] 'no authority from State Commissions' and [is] 'so

drawn as to complement and in no manner usurp State regulatory authority.'") (citation omitted).

NGA Section 1(b) acknowledges and preserves the States' regulatory authority. Moreover, the NGA's purpose of using federal regulation to fill in gaps in States' authority indicates that federal authority is limited, not expansive. Without clear and direct language mandating preemption of State regulatory authority, and with the language of Section 1(b) reaffirming continued State regulation, examination of the jurisdictional question for LDCs' capacity release to their own customers should have been based on whether such release fits within the intended scope of state, not federal, regulation. The Court failed to follow this course mandated by the statutory language and intent, and instead took the opposite approach of looking first to the scope of federal authority.[5]

The Court's improper approach led it to the wrong conclusion. The Court concluded that "states have *never* regulated the terms and conditions of interstate pipeline transportation." Pet. App. at 82a. This analysis looks only at transactions between pipelines and LDCs which occur at the federal level and which have been and remain subject to FERC jurisdiction. But the correct issue concerns regulation of the terms and conditions by which interstate pipeline capacity *is offered by LDCs to their customers*. Regulation

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[5] An analogous situation occurs in Tenth Amendment cases. The Amendment can be interpreted as giving States only that power which remains after the widest scope of federal authority has been determined. In such cases, the extent of States' power can be identified only after the breadth of federal power has been established. The structure of the NGA requires, however, the opposite approach because Congress limited federal authority to areas not reached by existing State regulation. Thus, analysis under the NGA requires that the regulatory reach of States be delineated first, and federal authority fit into areas outside those already delineated as controlled by States.

of this, as with bundled transactions between LDCs and their customers, has always been regulated by the States.[6]

Had the Court undertaken the proper analysis of looking first to the extent of State regulation in this area, it would have seen that capacity release between LDCs and their own customers falls within the field continually occupied by State regulation before and after passage of the NGA. From the appropriate perspective, FERC's action would have been seen to usurp State authority in contravention of Congress' intent.

B. Capacity Release Between LDCs and Their Customers Involves Matters of Important Local Concern

Strong local interests support the application of state, rather than federal, control over LDC capacity release to their customers. LDC pipeline capacity has been purchased and paid for by LDC customers through State-approved rates. The underlying grounds for an LDC's purchase of pipeline capacity as well as the use and charges related to that capacity are based largely, if not entirely, on local conditions. FERC's plan to centralize all capacity release under an overall federal umbrella ignores the equities created by local conditions. For example, an LDC might be required under FERC's plan to release pipeline capacity to out-of-state parties, rather than to its own end-users.[7]

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[6] The decisions of this Court have long established the power of the states to regulate transactions between LDCs and their end-users "even though the gas [is] brought from another State and drawn for distribution directly from interstate mains." *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298, 309 (1924). This power was incorporated into NGA Section 1(b). *See generally Panhandle Eastern Pipe Line Co.*, 332 U.S. at 516-19.

[7] The FERC policy could require a New York LDC to release its pipeline capacity to a Pennsylvania industrial end-user (as the highest

FERC's policy also ignores the inequity of releasing capacity to an out-of-state customer who has paid *none* of the reservation fees associated with the LDC purchase and ownership of that capacity, while denying access to the LDC's own end-users who have paid those fees for several years. Moreover, FERC's policy disrupts the local interests of states in promoting appropriate natural gas allocation policies. For example, a state's legitimate interest in favoring residential customers over industrial customers in the assignment of released capacity in the state might be disrupted. FERC's policy could mean industrial users from the same or different states take all the state's released capacity because they are the high bidders.

C. The Relevant Cases of this Court Affirm States' Power to Regulate Matters of Local Concern Under the Dual Jurisdictional Design of the Natural Gas Act

The States have long had power to regulate all aspects of the relationship between LDCs and their end-users. This power has not impeded FERC's ability to regulate interstate transportation of gas. *See Arkansas Elec. Coop.*, 461 U.S. at 395 ("the national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States."). LDC release of pipeline capacity to their own end-users should not be treated differently from other issues involving LDCs and their end-users. These matters raise matters of local concern, and thus are properly subject to state regulation.

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bidder) despite the LDC's New York residential end-users' need for that capacity to transport purchased gas.

Under dual jurisdiction, an LDC must follow the tariff approved by the FERC in contracting and paying for firm capacity from an interstate pipeline. At the state level, however, payments for firm capacity are one of many cost components that comprise the LDC's overall cost of service. The state agency has the authority, and a duty, to translate that cost of service into rates that satisfy local concerns, regardless of whether the state's balancing tracks federal balancing in analogous situations. *See Louisiana Pub. Serv. Comm'n v. Federal Communications Comm'n*, 476 U.S. 355, 375-76 (1986) (resulting "jurisdictional tensions" are not a reason to abandon dual jurisdiction).

Likewise, while the FERC may determine how pipelines may allocate capacity to LDCs for interstate transportation of gas, states retain authority over how interstate services purchased by the LDC are to be allocated or resold to end-users in connection with the local distribution of natural gas.

If the NGA required that all States follow exactly the same public interest balancing adopted on the federal level, there would have been no reason for dual jurisdiction. Congress could and should have simply occupied the entire field from production to distribution. But Congress did not do so: instead, it took "in only territory which this Court has held the states could not reach." *Panhandle Eastern Pipe Line Co.*, 332 U.S. at 519.

States cannot regulate interstate transportation of natural gas nor can they establish the rates or conditions under which a pipeline may offer firm capacity in the first instance to shippers. This limitation does not mean, however, that states are powerless to regulate distribution of gas transported via the capacity in interstate pipelines that LDCs have purchased. *See Panhandle Eastern Pipe Line Co. v. Michigan Pub. Serv. Comm'n*, 341 U.S. 329, 337

(1951) ("It does not follow that because appellant is engaged in interstate commerce, it is free from state regulation or free to manage essentially local aspects of its business as it pleases.").

In short, the release of an LDC's pipeline capacity to its own end-users does not give rise to the type of gap that federal regulation was intended to fill.

D. FERC's Capacity Release Plan at Issue Usurps Power that Properly Falls Within State Jurisdiction

FERC and the Court of Appeals attempt to justify the jurisdictional overreaching by claiming that capacity release by an LDC means "the pipeline is temporarily abandoning service to the releasing shipper [LDC] and instituting service to the replacement shipper [end-user]." Pet. App. at 80a (internal quotation marks and citations omitted). This attempted justification is belied, however, by (1) the LDC's continued obligation to pay reservation fees in the case of default and (2) the automatic reversion of the capacity to the LDC at the end of the release period.[8] Absent a full waiver of all tariff obligations during the release period, it cannot be said that abandonment has occurred.[9]

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[8] For example, LDCs may allow interruptible capacity release during off-peak periods, but require that it revert automatically to them if peak (e.g., low temperatures) conditions occur.

[9] One obligation that is not waived by the release of capacity is the reservation fees. In a real abandonment, an LDC would not be obligated for any further fees once abandonment has occurred. The LDCs continued obligation supports a conclusion that the purported abandonment involved in capacity release is a convenient fiction, not a reality, to support pipeline involvement (and, hence, a reason for FERC control) in these transactions.

The FERC also sought to justify its new approach on grounds that "uniformity among the various pipelines was necessary to 'prevent any pipeline or firm shipper from achieving an undue advantage, or incurring an undue disadvantage, *compared to firm shippers on other pipelines.*'" *Id.* at 74a (emphasis added) (citation omitted). But uniformity of rates, charges, and services between customers on different pipelines has never been expected, much less required.

The situations facing pipelines differ (for example, one pipeline may have lower construction costs because its facilities were built in relatively flat terrain), and these differences are reflected in rates and charges. Such differences do not create an *undue* disadvantage for shippers on other pipelines, but are considered part of the competitive landscape. Legitimate competitive differences and legitimate local concerns will necessitate differing treatment on different pipelines.[10]

Shippers on all pipelines throughout the country need not be forced into a single mold, as FERC suggests, because pipelines and shippers (e.g., LDCs) face different circumstances. A question of undue discrimination only arises when similarly situated shippers on the same pipeline are treated differently. Such problems can be solved at the federal level by approving pipeline tariffs that prevent such discrimination, and at the state level by retaining policies that treat similarly situated end-users similarly.

FERC's prior capacity release program addressed potential discrimination problems in each pipeline's tariff by mandating compliance with general policy goals, while

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[10] There is no *a priori* reason why shippers on, for example, an East Coast pipeline need be subject to the same capacity release conditions as shippers on, for example, a West Coast pipeline.

allowing flexibility to address differing individual circumstances. This flexibility allowed states and parties to deal with local concerns that might affect capacity release on one pipeline, but were of no moment on another pipeline. FERC's approach in the instant matter has eliminated the flexibility to address legitimate local concerns and legitimate competitive differences with a monolithic approach to all capacity releases on all pipelines.

FERC also declined to continue the prior capacity release arrangements because that would mean LDCs "are effectively determining by whom, and under what circumstances, gas will be transported and are using the pipeline's facilities as if they were the [LDCs'] facilities." *Id.* at 81a. The Court of Appeals found this "contrary to Congress' intent in enacting the Natural Gas Act" because it would allow LDCs to release capacity "without regard to the principles of open access and nondiscrimination." *Id.*

The purported justification rests on faulty grounds. FERC has and will continue to set the terms and conditions of pipeline tariffs as part of its jurisdiction over interstate transportation. Terms and conditions promoting the principles of open access and nondiscrimination have been and will continue to be part of FERC-approved tariffs. Both LDCs releasing capacity and end-users obtaining capacity will be bound by pipeline tariff conditions governing capacity release. Thus, it is impossible that capacity release will occur without regard to the principles of open access and nondiscrimination.

In short, FERC retains control over interstate transportation between pipelines and LDCs by means of its tariff approval power. This allows FERC to promote and to protect legitimate national interests. Within this framework, state regulation over LDCs and their end-users can continue, as envisioned by the dual jurisdiction of the NGA. FERC's

attempt to control the relationship between LDCs and their end-users directly contravenes the intent of the Natural Gas Act "to supplement, not to supplant state regulation." H.R. Rep. No. 899, 83rd Cong., 1st Sess. 1 (1953).

E. Unbundling Does Not Defeat State Jurisdiction Over Transactions Between LDCs and Their End-Users

The Court below accepted FERC jurisdiction over the entire capacity release field, including release by LDCs to their end-users, on the ground that capacity release involves interstate transportation over which FERC has jurisdiction. The Court reasoned that the "local distribution" exemption in NGA Section 1(b) "does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of gas." Pet. App. at 82a.

This interpretation rests on an assumption that the local distribution exemption is confined to "parceling out *accompanied by* retail sales." *Id.* at 79a (citation omitted). This rationale led the Court to conclude that state jurisdiction depends on whether the underlying transaction is bundled or unbundled. In the case of a bundled sale, the state can regulate the use of pipeline capacity by an LDC, but in unbundled situations, the state does not have authority over capacity:

> States have been -- and are still -- permitted to regulate LDCs' bundled sales of natural gas to end-users because those transactions include transportation over local mains and the retail sale of gas. In contrast, states have *never* regulated the terms and conditions of interstate pipeline transportation. When the gas sales element is severed -- i.e., unbundled

> -- from the transaction, FERC retains jurisdiction over *the interstate transportation component.*

Pet. App. at 82a.

The line between federal and state jurisdiction under the local distribution exemption might be more starkly contrasted, but it has not changed as a result of unbundling. FERC retains jurisdiction over the interstate transportation component whether or not a transaction is unbundled. Since enactment of the NGA, the FERC (or its predecessor) have had jurisdiction over the interstate transportation component of *all* sales by LDCs to their end-users. Notwithstanding this, states have effectively regulated sales by LDCs to their end-users throughout the entire period.

In the dual regulatory scheme, rates and conditions set by FERC for interstate transportation must be accommodated in a state's regulatory scheme. Accommodation of FERC's rates and conditions does not mean, however, elimination of a state's power to regulate. States can and have commonly adopted regulatory policies for matters within their jurisdiction that differ from, but do not disturb, FERC policies.

The ruling at issue negates dual regulatory power by giving the FERC control over all aspects of LDCs' capacity release to their own end-users. The transfer to sole FERC jurisdiction rests on the premise that capacity release involves only interstate transportation. Ignored is the fact that pipeline capacity is an integral part of the LDC facilities needed to fulfill the local distribution function of providing natural gas services to end-users under state-mandated public service obligation laws.

States have always regulated the relationship between LDCs and their end-users under the distribution function, while the FERC has regulated the relationship between pipelines and LDCs under the transportation function. FERC's capacity release program at issue upsets this jurisdictional split by overriding state regulation of distribution between LDCs and their end-users with a national policy that controls distribution of gas, and thus dictates what the relationship between LDCs and end-users will be.

VI. CONCLUSION

The FERC ruling at issue violates the intent of the NGA to supplement, not supplant, States' authority to regulate matters involving LDCs and their end-users. Relevant decisions of this Court have consistently upheld the dual jurisdiction and protected the States' regulatory power from encroachment by the federal government. Established principles of preemption also favor upholding state authority over these matters.

Granting the writ would allow this Court to affirm the statutory intent of the NGA and this Court's long-standing rulings upholding the States' continued authority to regulate the relationship between LDCs and their end-users.

WHEREFORE, the petition for a writ of certiorari should be granted.

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OPPOSITION

BRIEF

Nos. 96-1186, 96-1187 and 96-1188

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION OF RESPONDENTS PROCESS GAS CONSUMERS GROUP, AMERICAN IRON AND STEEL INSTITUTE AND GEORGIA INDUSTRIAL GROUP

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31pp

QUESTION PRESENTED

Whether the United States Court of Appeals for the District of Columbia Circuit correctly held that the Federal Energy Regulatory Commission ("FERC") did not exceed its jurisdiction under Natural Gas Act Section 1(b), 15 U.S.C.§ 717(b), Pet. App. at 1007a-1008a, to regulate the transportation of natural gas in interstate commerce by requiring the reallocation of interstate pipeline capacity between a local distribution company and its customers, or by a municipality, to comply with FERC's capacity release regulations.

RULE 29.6 LISTING

The Process Gas Consumers Group ("PGC") is an association of industrial consumers of natural gas organized to promote the development and adoption of coordinated, rational and consistent federal and state policies affecting industrial gas users. PGC members own and operate hundreds of manufacturing plants located throughout the United States. PGC has no parent or subsidiary companies.

The American Iron and Steel Institute ("AISI") is the principal trade association of the domestic steel industry. Its 35 domestic members account for approximately two-thirds of the raw steel production capability in the United States. AISI has no parent or subsidiary companies.

The Georgia Industrial Group ("GIG") is an association of industrial users of natural gas located in the states of Georgia and Alabama. GIG actively participates in variety of state and federal proceedings affecting the price of natural gas and electricity in the states of Georgia and Alabama. GIG has no parent or subsidiary companies.

Members of PGC, AISI and GIG consume substantial quantities of natural gas delivered through interstate natural gas pipelines.

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The Process Gas Consumers Group, American Iron & Steel Institute, and the Georgia Industrial Group, Respondents in the captioned cases, respectfully request that this Court deny the petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit (reported at 88 F.3d 1105 (1996)(Pet. App. at 1a to 174a)), submitted by local distribution companies ("LDCs") in No. 96-1186, state regulatory agencies ("PSCs") in No. 96-1188, and municipalities that own local distribution facilities ("municipalities") in 96-1187.

STATEMENT OF THE CASE

The Natural Gas Act ("NGA"), 15 U.S.C. § 717 et seq., provides the basic framework for regulation of the natural gas industry. Since 1978, the regulation of interstate transportation and sales for resale by interstate pipelines has undergone dramatic change. [1/]

Regulatory initiatives undertaken by the Federal Energy Regulatory Commission ("FERC") have "unbundled" the sales and transportation services formerly provided in "package" form by interstate pipelines. At the heart of that unbundling is the requirement of "open access" interstate transportation, which is based on the NGA's prohibition against "unduly discriminatory or preferential" rates or terms of pipeline services. 15 U.S.C. §§ 717c(b) and 717d(a). These initiatives

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1/ The court of appeals decision aptly described this regulatory evolution as having "gradually withdrawn from direct regulation of certain industry sectors in favor of a policy of 'light-handed regulation' when market forces make that possible." Pet. App. at 6a. Prior to 1978, producers typically sold gas to federally-regulated, interstate natural gas pipelines who, in turn, provided a combined, or "bundled," transportation/gas sales service to LDCs. The LDCs then provided a state-regulated, bundled retail sales/transportation service to end-users of natural gas.

enable all interested shippers -- including LDCs, end-users, producers and gas marketers -- to contract for interstate transportation of gas among virtually any combination of receipt and delivery points on an interstate pipeline. As a result, LDCs, producers, marketers and end-users are able to sell, buy and ship natural gas virtually anywhere on the interstate transportation grid. A dynamic, integrated national market for natural gas has emerged, complete with a vibrant futures market, actively traded regional markets, and a "secondary market" for interstate transportation rights. At the retail level, many States have implemented similar unbundling programs for LDC sales and transportation services.[2/]

1. **The Natural Gas Policy Act of 1978.**

Congress took the first step away from the bundled service approach in 1978 by enacting the Natural Gas Policy Act ("NGPA"). 15 U.S.C. § 3301 *et seq.*. The NGPA phased out regulation of wellhead prices charged by natural gas producers. As this Court recently observed, the NGPA also was designed to "promote gas transportation by interstate and intrastate pipelines." *General Motors Corp. v. Tracy*, 1997 U.S. Lexis 692, at *12 (decided February 18, 1997), *quoting* 57 Fed. Reg. 13271 (1992). Thus, with the NGPA, Congress began the process of introducing greater competition into natural gas markets by separating interstate pipelines' sales and transportation functions into discrete services.

2. **FERC Order No. 436.**

In 1985, FERC sought to further the NGPA's goal of a more competitive national wellhead market by promulgating

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2/ *See generally* U.S. Dept. of Energy, Energy Information Administration, "State Regulators Promote Consumer Choice in Retail Gas Markets," *Natural Gas 1996: Issues and Trends*, at 113-124 (Dec. 1996).

Order No. 436.[3/] In Order No. 436, FERC recognized that encouraging competitive gas markets required nondiscriminatory access to interstate pipeline transportation.[4/] Order No. 436 promoted nondiscriminatory access to the national transportation grid by, among other measures, providing "blanket certificates" (as opposed to the contract-specific, NGA Section 7(c) certificate otherwise required) for pipelines willing to provide transportation service pursuant to open access principles. At their core, these principles required interstate transporters to provide access to all shippers on a nondiscriminatory, "first-come, first-served" basis, even if the shipper intended to compete with the transporter in the sale of gas.[5/] In this way, Order No. 436 sought to afford downstream gas purchasers an alternative to buying gas under pipelines' bundled sales/transportation service.

In the wake of Order No. 436, pipelines sought FERC authorization for a variety of "capacity release,"[6/] "capacity

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3/ *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,665 (1985)("Order No. 436").

4/ *Id.* at 31,494-504.

5/ *Id.* at 31,516-518. *See Colorado Interstate Gas Co. v. FERC*, 890 F.2d 1121,1123 (D.C. Cir. 1989).

6/ *See, e.g., Arkla Energy Resources*, 53 FERC ¶ 61,127 (1990); *East Tennessee Natural Gas Company*, 53 FERC ¶ 61,304 (1990); *Florida Gas Transmission Co.*, 51 FERC ¶ 61,309, *order on reh'g*, 53 FERC ¶ 61,396 (1990).

brokering"[7] and "transportation assignment" programs.[8] Under such programs, shippers holding interstate pipeline capacity could reallocate their right to use some or all of their pipeline capacity to third-parties. In authorizing capacity brokering and assignment programs, FERC specifically reserved the right to modify or terminate the programs as required by the public convenience and necessity. *See Algonquin Gas Transmission Co.*, 59 FERC ¶ 61,032 at 61,092-93 (1992).[9]

When Congress completed the deregulation of wellhead prices with passage of the Natural Gas Wellhead Decontrol Act

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[7] *See, e.g., Algonquin Gas Transmission Co.*, 53 FERC ¶ 61,417 (1990); *Columbia Gas Transmission Corp.*, 49 FERC ¶ 61,071 (1989); *Kern River Gas Transmission Co.*, 50 FERC ¶ 61,069 (1990).

[8] *See, e.g., CNG Transmission Corp.*, 55 FERC ¶ 61,189 (1991); *Columbia Gas Transmission Corp.*, 49 FERC ¶ 61,071 (1989); *Texas Eastern Transmission Corp.*, 48 FERC ¶ 61,248, *order on reh'g*, 48 FERC ¶ 61,378 (1989), *order on reh'g*, 51 FERC ¶ 61,170, *order on reh'g*, 52 FERC ¶ 61,273 (1990).

[9] Contrary to the PSCs' characterization, FERC did not recognize in *Texas Eastern Transmission Corp.*, 48 FERC ¶ 61,378 at 62,552 (1989)("*Texas Eastern*") that "capacity purchased by LDCs in interstate pipeline facilities should be treated as the LDCs' (not the pipelines') own capacity." PSC Petition at 7. Consistent with "capacity assignment" programs generally, *Texas Eastern* considered reallocation of pipeline capacity held by a second interstate pipeline, Algonquin Gas Transmission Company, not an LDC. Thus, FERC had before it a capacity reallocation issue concerning two entities over which it clearly had jurisdiction; it did not consider whether upstream capacity held by a nonjurisdictional LDC could be considered an "expansion" of that LDC's system. Accordingly, the impression created by the LDCs' replacing the name "Algonquin" with the bracketed words "an LDC's" and "the LDC's" when quoting *Texas Eastern* -- that FERC acknowledged state jurisdiction over interstate capacity held by LDCs -- distorts the meaning of that decision.

of 1989,[10] it urged retention of Order No. 436's "open access" transportation regime. The Congress emphasized that:

> [T]hese new rules, and especially the wide adoption of blanket certificates for nondiscriminatory open access interstate transportation of non-pipeline gas, are essential to its decision to complete the decontrol process.

H.R. Rep. No. 29, 101st Cong., 1st Sess., at 6 (1989). Indeed, Congress encouraged FERC "to retain and improve this competitive structure in order to maximize the benefits of decontrol." *Id.*

3. FERC Order No. 636.

Notwithstanding the partial success of Order No. 436, FERC eventually concluded that shippers purchasing their gas supplies from nonpipeline sources were not receiving the same quality of transportation service as those taking the pipelines' bundled service.[11] This disparity in service quality led FERC to promulgate Order No. 636, which required pipelines

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[10] Pub. L. No. 101-60, 103 Stat. 157 (1989).

[11] *See Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations; and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs., Regulations Preambles 1991-1996 ¶ 30,939 at 30,398-407 (Pet. App. at 175a-407a, at 195a-215a), *order on reh'g*, Order No. 636-A, FERC Stats. & Regs., Regulations Preambles 1991-1996 ¶ 30,950 (Pet. App. 408a-812a), *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992)(Pet. App. 813a-998a), *reh'g denied*, Order No. 636-C, 62 FERC ¶ 61,007 (1993)(Pet App. 999a-1000a).

> to provide all transportation services on a basis that is equal in quality for all gas supplies whether purchased from the pipeline or from any other gas supplier.

Order No. 636, Pet. App. at 182a-183a. With Order No. 636, FERC completed its efforts to establish interstate pipeline transportation capacity and natural gas as separate "commodities" obtainable from different sources. Order No. 636 shifted FERC's regulatory focus away from judging the "comparability" of a pipeline's bundled and unbundled transportation services toward

> ensuring that pipeline transportation of all gas supplies is performed on an equal basis under reasonable transportation terms and conditions that enable buyers to use open access transport tion to maximize the benefits of a competitive wellhead natural gas market.

Id. at 234a.

As part of Order No. 636's pro-competitive regulatory initiatives, FERC established a framework to govern pipeline customers' reallocation of interstate pipeline transportation capacity to third parties. Previously, FERC had approved differing capacity release, brokering, and reassignment programs for individual pipelines. In Order No. 636, FERC concluded that a structured, industry-wide program permitting "capacity release" would better serve interstate markets than either a prohibition or a collection of individualized programs:

> First, . . . the Commission no longer believes that it can adequately monitor capacity brokering under existing certificates to ensure that all allocations are nondiscriminatory.

> Simply put, there are too many potential assignors of capacity and too many different programs for the Commission to oversee capacity brokering as it now exists. Second, the Commission believes that the two new generic allocation of capacity programs it is adopting make the necessary adjustments to eliminate the potential for firm capacity holders to unduly discriminate in their assignment of capacity, and facilitate the development of the secondary transportation market.

Id. at 238a-239a. Order No. 636's "capacity release" provisions permitted holders of unused interstate pipeline capacity to resell that capacity, either temporarily or permanently, to third-parties through a bidding system maintained by the pipeline. FERC explained that its capacity release mechanism "would afford buyers and sellers of firm capacity with one place to shop to ensure that firm capacity is used as efficiently as possible." *Id.* at 245a.

FERC's capacity release regulations, as supplemented by individual pipelines' tariffs, establish procedures for releasing transportation capacity rights and pipelines' execution of contracts with replacement shippers. Releases may be accomplished through bidding on a pipeline-sponsored electronic bulletin board or through "prearranged releases" negotiated between the releasor and replacement customer or through a combination of those procedures. Ultimately, however, while the terms of the release must be acceptable to the releasor, the terms of the release must also be consistent with the pipelines' filed tariffs and the replacement shipper must enter into a contract with the pipeline to receive the

released transportation service.[12/] Unless the release of capacity is permanent, the releasing shipper would remain liable on its contract with the pipeline, but would receive a credit against its bill for the capacity resold. *Id.* at 245a-252a.

4. The Court of Appeals Decision.

Local distribution companies, PSCs, and municipalities that own local distribution facilities sought judicial review of Order No. 636's capacity release regime. The LDCs challenged certain aspects of FERC's jurisdiction over capacity release transactions (Pet. App. at 79a-80a) and, together with the PSCs, argued that such transactions between LDCs and their customers came within the states' jurisdiction over "local distribution." *Id.* at 81a. The municipalities similarly maintained that their capacity release transactions were outside FERC's jurisdiction because municipalities do not come within the definition of a "natural gas company" subject to the NGA. *Id.* at 83a.

In its decision, the United States Court of Appeals for the District of Columbia Circuit rejected all challenges to FERC's capacity release program. The court of appeals found the release of interstate pipeline capacity to constitute an aspect of the interstate transportation of natural gas. The regulations governing such releases "operate as a term or condition of pipeline service, with which its customers must comply." *Id.* at 80a. Moreover, because this Court's decisions under the Commerce Clause precluded state regulation of interstate transportation, the court of appeals found that

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12/ Pipelines' tariffs permit negotiation of some terms, such as contract duration and, within limits, price. That is, the tariff permits a pipeline to charge rates between a filed maximum and a filed minimum, and neither the pipeline nor the releasor may charge rates outside the FERC-approved range.

> the federal government interceded to ensure stability and protect the interests of the consuming public. It thereby occupied the field, which necessarily includes both the sale and resale of interstate transportation rights.

Id. at 81a. Consequently, the court of appeals concluded that regulation of capacity release transactions fell within the exclusive and plenary jurisdiction over interstate transportation granted FERC under the NGA.

Having concluded that capacity release transactions came within FERC's general jurisdiction over interstate transportation, the court of appeals next declined to adopt the limitations on that jurisdiction proposed by the LDCs, PSCs, and municipalities. The court of appeals found that the jurisdiction over "local distribution" granted states by NGA Section 1(b) "does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of natural gas," *Id.* at 82a, and concluded that "states have never regulated the terms and conditions of interstate pipeline transportation." *Id.*

With regard to the municipalities' definitional argument, the court of appeals reasoned that "FERC's transportation jurisdiction extends as a separate matter over capacity release given the involvement of interstate gas pipelines," *Id.* at 84a, and further observed that "the transaction itself controls access to interstate transportation capacity, entirely independent of the jurisdictional nature of the releasing and replacement shippers." *Id.* at 85a. The court of appeals found "most persuasive" the analogy between FERC's curtailment regulations and the capacity release program, in that "both involve the pipelines' allocation of transportation capacity among their shippers in compliance with federally mandated strictures." *Id.*

REASONS WHY THE PETITIONS SHOULD BE DENIED

I. Petitioners Have Not Demonstrated a Compelling Reason Justifying This Court's Review of the Court of Appeals Decision.

Rule 10 of this Court's Rules instructs that review on a writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only for "compelling reasons." While not an exhaustive listing, Rule 10 identifies reasons that could prove sufficiently compelling to justify the granting of a writ of certiorari. Examples theoretically applicable to the court of appeals decision at issue include conflicting decisions between United States courts of appeals on an important matter, important federal law questions of first impression requiring resolution by this Court, or a court of appeals decision regarding an important federal question that conflicts with relevant decisions of this Court.

Here, the petitions in Nos. 96-1186, 96-1187, and 96-1188 fail to identify a credible, let alone compelling, reason to justify granting a writ of certiorari. The petitions point to the decision of no other circuits with which the court of appeals decision at issue conflicts. The petitions do not purport to identify an important federal question of first impression requiring resolution by this Court. Nor do the petitions demonstrate a conflict between the court of appeals decision and any decision of this Court concerning an important federal question.

The petitions do not challenge the court of appeals' determination that promulgation of the capacity release program represents a permissible exercise of FERC's jurisdiction over the interstate transportation of natural gas. Instead, the petitions argue more narrowly that FERC exceeded

its jurisdiction in applying its capacity release regulations to releases between LDCs and their customers, and by municipalities. According to one petition:

> As should be clear, this petition presents no challenge to the concept of "unbundling" or the overall objectives of the federal plan. Rather, it concerns only the question of ultimate control over one aspect of the current market structure, the resale of capacity by LDCs to in-state customers.

LDC Petition at 24. The petitions disagree at length with the analytical approach adopted by the court of appeals in resolving their jurisdict ional claims, maintaining that inadequate attention was paid to State regulatory prerogatives preserved by the NGA. LDC Petition at 18-20; PSC Petition at 11-13; Municipalities Petition at 9-12.

The petitions fail to identify an "important federal question" warranting this Court's attention. The narrow jurisdictional arguments posited by the PSCs, LDCs and municipalities rest on the fundamental mischaracterization of capacity release transactions between LDCs and their customers, and by municipalities, as "local distribution services" traditionally provided subject to state or local regulation. In fact, the release of interstate pipeline capacity plainly involves interstate transportation by interstate pipelines, not local distribution service -- as the court of appeals correctly found and the petitions do not contest. The released interstate transportation rights extend across many states -- from Texas and Louisiana to New York and Massachusetts and everywhere in between -- and require a contract between the transporting pipeline and the replacement shipper that acquires the service. Indeed, the ability of LDCs and municipalities to release interstate pipeline capacity directly results from FERC's

regulation of interstate pipeline services, including the unbundling of services offered by interstate pipelines. Consequently, as explained in Section II, *infra*, the release of interstate pipeline capacity by LDCs and municipalities, whether to their customers or any other third party, falls within FERC's exclusive jurisdiction over the interstate transportation of natural gas.

Furthermore, while the petitions occasionally reference this Court's precedents regarding the boundaries of federal and state jurisdiction under the NGA, at no time do they identify a single holding of this Court with which the court of appeals decision purportedly conflicts. Indeed, the municipalities' petition attacks the court of appeals for its supposed failure to adhere to *FERC* precedents, not the prior holdings of this Court. *See* Municipalities Petition at 12-19.

At best, the petitions evidence continuing disagreement with the jurisdictional conclusions reached by the court of appeals; however, mere disagreement with the court of appeals, no matter how deeply felt or forcefully expressed, does not justify review by this Court. Thus, the petitions manifestly fail to present a compelling reason for this Court to review the decision of the court of appeals. Accordingly, the petitions for writ of certiorari in Nos. 96-1186, 96-1187, and 96-1188 should be denied.

II. The Court of Appeals Decision Is Consistent with Both the NGA and This Court's Precedents Regarding the Scope of Federal Jurisdiction Over the Transportation of Natural Gas in Interstate Commerce.

The court of appeals decision is entirely consistent with both the NGA and this Court's prior precedents concerning the jurisdictional boundaries between federal and state regulatory

responsibilities. The NGA subjects the natural gas industry "to interlocking regulation by both federal and state authorities." *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, 489 U.S. 493, 506 (1989)("*Northwest*"). The framework for this "interlocking regulation" is set forth in NGA Sections 1(b) and 1(c). *See* 15 U.S.C. §§ 717(b),(c). NGA Section 1(b) provides, in pertinent part, that the statute's provisions "shall apply to the transportation of natural gas in interstate commerce . . . and to natural-gas companies engaged in such transportation." 15 U.S.C. § 717(b). The NGA

> contemplated the exercise of federal power as specified in the Act, particularly in that interstate segment which the states were powerless to regulate because of the Commerce Clause of the Federal Constitution.

FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498, 502-503 (1949).

This Court repeatedly has interpreted Section 1(b)'s grant of federal jurisdiction over interstate transportation as affording "exclusive Federal Energy Regulatory Commission jurisdiction over 'the transportation of natural gas in interstate commerce . . . .'" *Northwest*, 489 U.S. at 510. The Court has declared it "well settled" that "Congress occupied the field of matters relating to . . . transportation of natural gas in interstate commerce." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 305, (1988)("*Schneidewind*"). *See also FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972)("*Louisiana Power & Light*), *quoting Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947)(Congress drew three things "within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission" including "the transportation of natural gas in

interstate commerce"); *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 503 (1949)(same). In so doing, Congress intended that FERC "regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 91-92 (1963)("*Northern Natural Gas*"). *See also Schneidewind*, 485 U.S. at 310 ("uniformity of regulation . . . was an objective of the Natural Gas Act").

This Court has soundly rejected previous attempts to read into NGA Section 1(b) limitations on FERC's plenary jurisdiction over the interstate transportation of natural gas. In *Louisiana Power & Light*, the Court dismissed the contention that federal jurisdiction over transportation applied only to interstate pipeline "sales for resale" and did not reach "direct sales" by interstate pipelines to end-users. The Court explained that each of the areas reserved to federal jurisdiction by Section 1(b)

> is an independent grant of jurisdiction and, though the Act's application to "sales" is limited to sales of interstate gas for resale, the Act applies to interstate "transportation" regardless of whether the gas transported is ultimately sold retail or wholesale.

406 U.S. at 636. Similarly, in *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950)("*East Ohio Gas*"), the Court refused to read the federal jurisdiction over interstate transportation as limited to companies that either transported "gas in interstate commerce for hire or for sales to be followed by resales." *Id.* at 468. According to the Court, "the short answer is that the Act's language did not express any such limitation." *Id.* The Court went on to observe that:

> [T]hroughout the Act "transportation" and "sale" are viewed as separate subjects of regulation. They have independent and equally important places in the Act. Thus, to adopt respondents' construction would unduly restrict the Commission's power to carry out one of the major policies of the Act.

Id. [13/]

Contrary to the LDCs' contention that "the perceived federal need for uniformity must give way to the primacy of state regulation as guaranteed by the Act," LDC Petition at 19, this Court has made clear that state regulation may not impinge upon FERC's ability to achieve the comprehensive regulatory scheme mandated by the NGA. Even where a state purports to regulate within a sphere reserved to its jurisdiction by the NGA, "[s]tate regulation . . . may be pre-empted as conflicting with FERC's authority over interstate transportation . . . if state regulation prevents attainment of FERC's goals." *Northwest*, 489 U.S. at 515-16; *Schneidewind*, 485 U.S. at 299-300. For example, in *Northern Natural Gas*, the Court invalidated certain regulatory orders promulgated by the State of Kansas ostensibly pursuant to its NGA Section 1(b) jurisdiction over "production or gathering." Because the orders at issue required an interstate pipeline to purchase gas in a certain manner, the Court concluded that:

[13/] NGA Section 1(c), passed by Congress in response to *East Ohio Gas*, does not alter the scope of FERC's jurisdiction over the interstate transportation of natural gas. This Court recently characterized Section 1(c) as simply a Congressional acknowledgement regarding "the important role of the States in regulating *intrastate* transportation and distribution of natural gas." *General Motors Corp. v. Tracy*, 1997 U.S. Lexis 692, *28 (decided February 18, 1997)(emphasis added).

> These State orders necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain.

372 U.S. at 91-92. In such situations, the Court emphasized that "[n]ot the federal but the state regulation must be subordinated, when Congress has so plainly occupied the regulatory field." *Id.* at 93. *See also Schneidewind*, 485 U.S. at 310, *quoting Northern Natural Gas*, 372 U.S. at 91-92 ("prospect of interference with the federal regulatory power" permits pre-emption of state law even though "collision between the state and federal regulation may not be an inevitable consequence").

The language of NGA Section 1(b), and this Court's prior decisions interpreting it, make plain that FERC possesses exclusive jurisdiction to regulate a particular *activity, i.e.* transportation of natural gas in interstate commerce. While Section 1(b) also affords FERC jurisdiction over particular entities engaged in such transportation (*i.e.* "natural-gas companies"), this represents a separate jurisdictional grant that does not modify or constrain FERC's Section 1(b) jurisdiction over interstate transportation of natural gas. In other words, FERC's jurisdiction over the interstate transportation of natural gas *is wholly unrelated to the nature of the entities involved in that activity.* For this reason alone, contentions that capacity release transactions between LDCs and their customers, or by municipalities, lie wholly outside FERC's jurisdiction over interstate transportation, are without merit.

Moreover, the NGA's goal of uniform regulation for the interstate transportation of natural gas, together with the states' acknowledged lack of jurisdiction over that activity at the time Congress passed the NGA, further support the conclusion, reflected in the decisions of this Court, that FERC possesses plenary jurisdiction over such interstate transportation. Furthermore, this Court's prior decisions unambiguously instruct that state regulation *even if nominally within a regulatory sphere reserved to the states by the NGA*, must yield to FERC's jurisdiction if such state regulation would hinder or frustrate FERC's efforts to achieve comprehensive, uniform regulation of interstate transportation.

Here, the court of appeals determined that capacity release transactions were part of an activity -- the interstate transportation of natural gas -- committed to FERC's exclusive jurisdiction by the NGA. Having so found, the court of appeals, in light of the NGA's language and purpose, as well as the prior decisions of this Court, necessarily rejected the contentions, pressed here by the petitions, that the NGA reserved regulation of capacity release transactions between LDCs and their customers, and by municipalities, to state or local authorities. To do otherwise would have opened the door to the regulation of capacity release transactions by multiple state and local regulatory bodies, thereby hindering, if not precluding, FERC's ability to regulate an aspect of interstate transportation -- the reallocation of interstate pipeline capacity -- in the comprehensive, uniform manner intended by the NGA.

Finally, the petitions do not dispute the court of appeals' determination that capacity release transactions are matters subject to FERC's NGA Section 1(b) jurisdiction over interstate transportation. Petitioners' concession on this general jurisdictional determination is fatal to their specific jurisdictional arguments about releases in specific settings. Having conceded that capacity release transactions come within

FERC's exclusive NGA jurisdiction over the interstate transportation of natural gas, Petitioners cannot then credibly argue that the statute simultaneously guarantees "the primacy of state regulation," (LDC Petition at 19) regarding the interstate transportation activities of certain entities (*i.e.*, LDCs and municipalities). Indeed, as noted earlier, the states' *complete lack* of jurisdiction over the interstate transportation of natural gas represented one of the factors necessitating passage of the NGA. If, as the PSCs contend, the NGA intended to reserve to the states "those areas which they had historically controlled," PSC Petition at 11, then Congress could not have reserved to the states the right to regulate an interstate transportation activity such as capacity release because, as the petitions concede, the Commerce Clause denied the States any authority to regulate the transportation of natural gas in interstate commerce. LDC Petition at 4; PSC Petition at 11.

III. The PSC and LDC Petitions Fail to Demonstrate That Capacity Release Transactions Fall Within the States' Jurisdiction Over "Local Distribution."

The petitions submitted by the PSCs and the LDCs make much of the "historic state authority over LDCs and intrastate customers." LDC Petition at 25. *See also* PSC Petition at 14 ("the States long have had power to regulate all aspects of the relationship between LDCs and their end-users"). The PSCs and LDCs contend that, through the jurisdiction reserved to the states by NGA Sections 1(b) and 1(c), Congress intended that states retain "a *comprehensive* scheme of rate control over LDCs." LDC Petition at 24 (emphasis in original). *See also* PSC Petition at 15 ("the state agency has the authority, and a duty, to translate that cost of service into rates that satisfy local concerns"). This comprehensive scheme of state regulation purportedly requires "consistency and exclusivity of control over LDCs' relationship with their local customers"

including the manner in which LDCs reassign their right to use interstate pipeline capacity to those customers. LDC Petition at 24. Otherwise, LDCs might release their interstate pipeline capacity exclusively to out-of-state interests, thereby denying LDC ratepayers the benefit of their "investment" in interstate pipeline capacity. LDC Petition at 27; PSC Petition at 13-14. The PSCs and LDCs characterize FERC's NGA jurisdiction as wholly derivative of and supplemental to the states' jurisdiction. *See, e.g.,* LDC Petition at 19 ("the scope of state authority should have been the touchstone for determining the scope of federal authority"); PSC Petition at 11 (NGA enacted "to fill the gaps in regulatory authority where the States were precluded from acting"). However, whether or not one agrees with the petitioners' policy quarrel with FERC, the petitioners' jurisdictional arguments are baseless.

The interpretation of NGA jurisdiction proffered by the PSCs and LDCs attempts to bootstrap state regulatory authority over rates for "local distribution" into a broader jurisdictional mandate. By framing the crux of their jurisdictional argument in malleable terms such as "the service that LDCs provide to their customers," PSC Petition at 10, and "local distribution companies' services to end-users within the state" LDC Petition at 18, they subtly seek to expand the scope of activities subject to state regulatory authority.

The release of interstate pipeline capacity by an LDC to its customer, however, is not a "service" subject to state jurisdiction for the fundamental reason that it is not a "service" that the states possess authority to regulate on their own. Recall that after issuance of Order No. 436, FERC -- not state regulatory agencies -- authorized pipelines' capacity release, capacity brokering, and capacity reassignment programs. *See supra* notes 6-8.

As the court of appeals correctly determined, capacity release requires either the *temporary or permanent abandonment* of pipeline service to one interstate pipeline customer and the corresponding *initiation of interstate transportation* service to the "replacement" shipper. Pet. App. at 80a. Both abandonment and initiation of interstate transportation service -- the core elements of a capacity release transaction -- are committed to FERC's jurisdiction by NGA Sections 1(b), and are made expressly subject to FERC's approval by NGA Sections 7(b) and 7(c), respectively. 15 U.S.C. §§ 717f(b)(c). For these reasons, plus FERC's exclusive authority over pipelines' tariffs terms and conditions, the court of appeals was correct in concluding that the states "have never regulated the terms and conditions of interstate pipeline transportation." Pet. App. at 82a.

Furthermore, even assuming for argument's sake that FERC's jurisdiction over capacity release transactions was uncertain, the consequences that flow from the state-centric jurisdictional analysis urged by the PSCs and LDCs would necessitate committing those transactions to federal jurisdiction. As this Court explained in *FPC v. Louisiana Power & Light Co*, 406 U.S. 621, 631 (1972):

> [I]n a borderline case where congressional authority is not explicit we must ask whether state authority can predictably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs.

(*quoting FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 19-20 (1961)). There, the Court decided that direct sales by interstate pipelines to end-users -- which are not subject to FERC rate regulation -- were subject to FERC's curtailment regulations. In addition to finding curtailment a

matter of interstate transportation, the Court concluded that "[c]omprehensive and equitable curtailment plans for gas transported in interstate commerce . . . are practically beyond the competence of state regulatory agencies." *Louisiana Power & Light*, 406 U.S. at 641. The Court reasoned that:

> the inevitable result would be varied regulatory programs of state courts and agencies, interpreting a countless number of different contracts and applying a variety of state agency rules . . . Besides, a state agency empowered to regulate these contracts would be obliged to regulate in the State, not the national interest.

Id. at 633.

Here, the PSCs and LDCs assert state jurisdictional preeminence over but one aspect of capacity release transactions: releases of interstate transportation made by LDCs to their customers. *See* PSC Petition at 13, 14; LDC Petition at 3, 24. Their petitions do not contend, for example, that releases made by LDCs to entities outside their service territories, or releases obtained by an LDC's end-user customers from an entity other than the LDC, come within a state's regulatory jurisdiction. Thus, even if accepted, the PSCs' and LDCs' jurisdictional claims would leave states without authority to "predictably regulate" all capacity release transactions. Under such circumstances, *Louisiana Power & Light* teaches that extension of state jurisdiction would be unwarranted.[14/]

[14/] This analysis applies with equal force to the municipalities' argument that their capacity release transactions -- but not other capacity release transactions -- are definitionally excluded from FERC's NGA jurisdiction and, therefore, are subject to state or local regulation.

Moreover, partial state jurisdiction over certain capacity release transactions inevitably would bring about the type of cross-cutting, self-interested state regulatory actions eschewed by the Court in *Louisiana Power & Light*. Worse still, the jurisdictional theory espoused by the PSCs and LDCs would produce simultaneous FERC/state regulation of capacity release transactions, the very kind of "overlapping control" that, according to Petitioners, Congress did not intend when it passed the NGA. LDC Petition at 18. *See also* PSC Petition at 14-16 (discussing NGA's "dual jurisdictional design"). If every state could promulgate its own regulations governing LDCs releases of interstate capacity to their own customers, a system of preferences and rates could develop that would interface with interstate transportation access and the federally approved interstate capacity release market. Indeed, the conflicting state and federal regulatory objectives described by the LDCs' petition all but ensure that the dual jurisdiction over capacity releases produced by their interpretation of the NGA would yield regulatory conflict. *See* LDC Petition at 25-28.

Finally, contrary to the PSCs' and LDCs' contentions, FERC's capacity release regulations do not infringe on the states' legitimate ratemaking jurisdiction regarding local distribution service. FERC's regulations establish the maximum rate that can be charged for interstate transportation, including in a capacity release transaction; they do not affect how costs incurred by LDCs are treated for ratemaking purposes at the state level. States' regulatory bodies remain free to allocate the costs of pipeline capacity among LDC customer classes in the manner they deem in the public interest. Equally important, state regulators can (and do) require LDCs to use revenues obtained through capacity releases to reduce the fixed costs borne by the ratepayers whose rates have

"purchased" that interstate pipeline capacity.[15/] In this way, the LDC's ratepayers benefit from its capacity release transactions. Accordingly, claims that ratepayers will lose the benefit of their "investment" in interstate pipeline capacity absent state jurisdiction over LDC capacity release transactions lack substance.

15/ *See, e.g., Re Guidelines for Further Unbundling of Natural Gas,* 148 P.U.R. 4th 441, 444 (N.J. BPU 1993)(directing that the aim of an LDC's capacity release program "should be to provide the greatest contribution to the system's fixed capacity costs, while maintaining reliability for the firm sales customers").

CONCLUSION

For the foregoing reasons, the petitions for writ of certiorari in Nos. 96-1186, 96-1187, and 96-1188 should be denied.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,

Petitioners,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF *AMICI CURIAE* OF THE AMERICAN GAS ASSOCIATION AND CITIZEN ACTION

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BRIEF *AMICI CURIAE* OF THE AMERICAN GAS ASSOCIATION AND CITIZEN ACTION

Pursuant to Rule 37.2, the American Gas Association (hereafter "A.G.A.")[1] and Citizen Action (hereafter "Citizen") respectfully submit this brief *amici curiae* in support of the petitions for writ of *certiorari* filed by petitioners Associated Gas Distributors, et al., ("AGD") the Public Service Commission for the State of New York, *et al.*, and the American Public Gas Association, *et al.*("APGA"). The written consents of the parties are attached.

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1 Public Service Company of North Carolina does not join in this brief.

INTEREST OF THE *AMICI CURIAE*

A.G.A. is a national non-profit trade association representing over 200 local distribution companies (hereafter "LDCs" or "gas distributors") principally engaged in distributing natural gas in the 50 states and the District of Columbia. A.G.A. member companies provide retail gas sales and transportation service to more than 55 million residential, commercial and industrial customers across the nation within state designated service territories.

Citizen Action is a nationwide consumer and environmental watchdog organization with over two million members in 31 states. A large percentage of Citizen Action members are residential consumers of natural gas and are concerned about the availability and price of natural gas supplies.

The question presented by AGD and the state commissions is whether the Federal Energy Regulatory Commission ("FERC" or "the Commission") has jurisdiction over LDCs' release to local retail customers of the rights LDCs have purchased to use pipeline capacity to serve local retail sales customers, even though Sections 1(b) and 1(c) of the Natural Gas Act ("NGA" or "the Act")[2] each expressly grant FERC jurisdiction only where states constitutionally cannot act. Similarly, APGA presents the question whether FERC can regulate municipalities' release of pipeline capacity despite the NGA's unequivocal exemption of municipal gas companies from FERC regulation.

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[2] 15 U.S.C. § 717 (b) & (c) (1994) (Pet. App. at 1007a - 1009a).

As national associations of local distributors and gas consumers, A.G.A. and Citizen have a particular interest in the preservation of the statutory prohibition of federal jurisdiction to regulate distribution of natural gas. The opinion of the United States Court of Appeals for the District of Columbia Circuit, affirming the Commission's authority over releases of pipeline capacity rights by LDCs to their retail sales customers, eviscerates the jurisdictional scheme codified by Congress in the NGA by undermining the authority of state regulatory agencies and municipalities to regulate effectively local natural gas distribution companies.

A.G.A. and Citizen accordingly submit this brief *amici curiae* urging the Court to issue its writ of *certiorari* to consider this matter.

SUMMARY OF ARGUMENT

FERC has extended its regulation of open access pipeline transportation to the secondary market in transportation, even under circumstances where LDCs seek to release pipeline capacity rights to their own local retail sales customers for whom they have purchased those rights. Under FERC's rules, unless releases are prearranged at the pipeline's maximum tariff rate or are for a month or less duration, releases of capacity by LDCs must be posted on an electronic bulletin board and are auctioned to the highest bidder, subject to a cap equal to the pipeline's maximum monthly tariff rate. FERC's assertion of jurisdiction over releases of capacity by LDCs to their own retail customers impedes state regulators from ensuring that the local retail customers that pay rates reflecting the full costs of the pipeline capacity in fact gain the benefit of those capacity rights.

LDCs contracted for these capacity rights to provide firm sales service to their local retail sales customers. This retail sales service is subject to the exclusive jurisdiction of the states. Because of FERC's open access pipeline transportation policy, many of these customers now are able to purchase gas from alternative suppliers, but they need to use the pipeline capacity to access alternative suppliers. LDCs and state regulators seek to enable these local retail customers to use the capacity rights the LDC purchased to serve these retail customers through direct releases, unencumbered by FERC's regulation.

FERC's rules interfere with the implementation of state energy policy. FERC's assertion of jurisdiction over capacity releases to local retail customers hampers states in devising optimal mitigation of the firm embedded cost rates paid by LDCs and passed along to firm retail customers. FERC's rules hamper states in crafting programs to enhance local customers' competitive options in the evolving competitive energy markets. The rules interfere with states' ability equitably to allocate the embedded cost of gas transportation to both electricity and gas sold in retail markets.

FERC's regulation, instead, fosters releases of capacity to marketers who often sell to large end-users located out of state. The marketers generally pay only a fraction of the embedded costs of the transportation capacity that are paid by the LDC's residential, small commercial and other firm retail sales customers for whom the capacity is reserved. Thus, the marketers and out-of-state end-users benefit from deep discounts to transportation costs that essentially are paid by the local retail sales customers. In addition, because many

of these out-of-state end-users are electric generators, FERC's rules skew retail energy markets against LDC-supplied gas that bears the full embedded costs of the pipeline's transportation service.

In regulating capacity releases by LDCs to local retail customers, FERC is treading on ground that Congress, in the Natural Gas Act, left to the states to regulate. This Court emphatically and consistently has upheld the principle that the NGA created FERC jurisdiction only over those areas of natural gas transportation and sales that states constitutionally were unable to regulate. Regulation of LDCs' release to local retail customers of transportation capacity purchased to serve those customers is a matter that, under traditional principles of NGA federalism, should be left to the states. FERC has usurped state authority and the court below erred grievously in affirming FERC's decision with respect to this issue.

FERC's rules governing capacity release suffer from the same fatal flaw as the Commission's "Special Marketing Programs" of the mid-1980's, which were remanded by panels of the D.C. Circuit including then Judges Scalia and Ginsburg, in the *Maryland Peoples Counsel v. FERC* cases.[3] The capacity release rules favor large out-of-state end-users, that are not captive to firm gas service, over residential, small commercial and other firm LDC retail customers. These rules stifle development of a robust secondary market in transportation capacity that would benefit all consumers and not just a few favored large volume end-users.

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[3] *Maryland People's Counsel v. Fed. Energy Reg. Comm'n*, 761 F.2d 768 (D.C. Cir. 1985)("MPC I"), 761 F.2d 780 (D.C. Cir. 1985)("MPC II").

ARGUMENT

THE LOWER COURT'S DECISION UNLAWFULLY ALLOWS FERC TO USURP STATE AUTHORITY TO REGULATE NATURAL GAS DISTRIBUTORS' USE OF PIPELINE CAPACITY PURCHASED TO SERVE LOCAL RETAIL CONSUMERS.

A. The Natural Gas Act Preserved the Full Scope of State Regulatory Authority Over LDCs' Activities to Serve Local Retail Consumers and Extended Federal Jurisdiction Only in Areas Where States Constitutionally Cannot Act.

The NGA, 15 U.S.C. §§ 717-717z, conferred upon the Federal Power Commission, precursor to FERC, the power to regulate certain aspects of interstate commerce in natural gas in order to protect the public interest. This Court has confirmed time and again, most recently in *General Motors Corp. v. Tracy,* that Congress intended not to occupy the entire field of its commerce clause power to regulate commerce in natural gas.[4] Rather, Congress intended to occupy only the

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[4] *See General Motors Corp. v. Tracy, Tax Comm'r of Ohio*, No. 95-1232, slip op. at 12 (U.S. Feb. 18, 1997)(stating that the Natural Gas Act left "undisturbed the recognized power of the States to regulate all in-state gas sales directly to consumers"); *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n,* 332 U.S. 507, 516 (1947) (holding that the Natural Gas Act did not preempt state regulation of local direct sales by pipelines to industrial users).

portions of the field not subject to state regulation. The Act expressly provides that federal jurisdiction does not extend to "any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution . . ." 15 U.S.C. § 717(b) (Pet. App. at 1007a - 1008a). *See also* 15 U.S.C. § 717(c) (Pet. App. at 1009a). In upholding the Commission's strained expansion of the NGA, the lower court nullifies the exemption provided by the NGA and thereby allows FERC to intrude into areas Congress expressly left to local control.

LDCs historically purchased bundled service that included gas supplies and firm transportation on interstate pipelines to serve residential, commercial and other retail customers with firm energy needs. Because pipelines now transport for many suppliers, LDCs now manage portfolios of gas supplies they purchase from a variety of sources. LDCs must continue to maintain contracts with pipelines for sufficient firm transportation capacity rights to meet the needs of customers that continue to look to the LDC for reliable gas distribution service, especially on the coldest days of the year.

Under FERC-mandated pipeline rate design, LDCs pay an allocation of the full embedded costs of the pipeline capacity reserved to meet the gas supply needs of their customers. These costs in turn are recovered in the LDC's rates to its firm customers. To mitigate these costs and to enhance efficient use of pipeline capacity, LDCs seek to sell to other shippers transportation capacity rights that the LDCs do not need during any given period. When LDCs transfer these capacity rights directly to their own retail customers, the release should not be subject to FERC's encumbering capacity release program. FERC's assertion of jurisdiction over such direct transfers of capacity rights

to local retail customers precludes states from governing how the value of the capacity purchased incident to retail sales service is allocated among the retail customers that are paying to reserve that capacity. FERC's assertion of jurisdiction here has usurped states' authority to regulate the local economic issues entailed in providing reliable retail gas service.

The decision below affirmed FERC's assertion of jurisdiction over LDCs' release of transportation capacity to local retail customers. In so doing, the court failed to give effect to the full measure of state authority in the area, and instead assumed, contrary to this Court's consistent instruction, that the NGA fully occupied the potential scope of federal jurisdiction.

Petitioners have set forth why federal regulation of LDCs' and municipal utilities' management of the capacity rights they purchase to serve their local sales customers and seek to release to local retail customers exceeds the Commission's authority under the Natural Gas Act. The state commissions' petition describes how FERC's regulation impedes states' rights effectively to protect the economic interests of the captive retail consumers of natural gas. A.G.A. supports but will not repeat these arguments; instead we describe how the Commission's regulation has the perverse effect of penalizing precisely the natural gas consumers that the NGA is intended to protect.

B. Competition and Open Access Unbundled Transportation Fundamentally Have Altered Commercial Relationships in Natural Gas Markets, But NGA Jurisdiction Remains Circumscribed by State Authority to Regulate Commerce in the Interests of Local Retail Consumers.

To foster a more competitive natural gas market, Congress passed the Natural Gas Policy Act of 1978 ("NGPA") which removed "first" sales (usually by producers) of natural gas from FERC jurisdiction under the NGA.[4] A competitive spot market in natural gas developed along with a gas futures market to support it. But the wellhead market continued to remain dominated by pipeline purchasers of gas because other purchasers had no meaningful access to the pipeline transportation systems essential to reach consumers. FERC's initial "experimental increase in [natural gas] pipeline competition" was rejected as too narrow by the D.C. Circuit in the *Maryland Peoples Counsel* cases.[5] In those cases, panels led by then Judges Scalia and Ginsburg remanded FERC's "Special Marketing Programs" that had favored industrial end-users of natural gas at the expense of residential and small commercial consumers and thereby harmed rather than helped "the consumers whom the Natural Gas Act was

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[4] 15 U.S.C. §§ 3301 - 3348 (1994).

[5] 761 F.2d 768, 770 (brackets in original); *see also* 761 F.2d 780, 781 ("[t]his case features [FERC] blanket permission for interstate transportation of natural gas sold directly by producers to end users").

designed to protect." MPC II, 761 F.2d at 781 (internal quotations omitted).

In part responding to these cases, the Commission promulgated rules providing for non-discriminatory, "open access" transportation of gas by pipelines,[6] culminating in the Order No. 636 series, reviewed and remanded in part by the opinion below.[7] Briefly, Order No. 636 prohibited pipelines from selling the commodity gas bundled under a single price with the transportation service required to deliver the gas to the LDC buyer. Instead, Order No. 636 required pipelines to offer all transportation and storage services separately from the commodity, on an "open access" basis to all shippers, including those that buy gas from the pipeline (or the pipeline's marketing affiliate), under nondiscriminatory terms and conditions. The goal of requiring "open-access" transportation unbundled from the gas sale itself, the Commission said, was to "maximize the consumer benefits of the competitive

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[6] *See General Motors,* slip op at 13-14; *see also* Richard J. Pierce, "The Evolution of Natural Gas Regulatory Policy," Nat. Resources and Env't L.J., Summer 1995 at 53 (providing an overview of the history of natural gas regulation).

[7] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13267, III FERC Stats. & Regs. Preambles ¶ 30,939 (1992) ("Order No. 636") (Pet. App. at 175a - 407a); *Order on Reh'g*, 57 Fed. Reg. 36128, III FERC Stats. & Regs. ¶ 30,950 ("Order No. 636-A) (Pet. App. at 408a - 812a) *Order on Reh'g*, 57 Fed. Reg. 57911, 61 FERC ¶ 61,272 (1992) ("Order No. 636-B") (Pet. App. at 813 a - 998a); *Reh'g Denied*, 62 FERC ¶ 61,007 (1993) ("Order No. 636-C) (Pet. App. at 999a - 1000a), upheld in part and remanded in part, *United Distribution Cos. v. Federal Energy Regulatory Comm'n*, 88 F.3d 1105 (D.C. Cir. 1996) (Pet. App. at 1a - 174a); *order on remand*, 78 FERC ¶ 61,186 (Feb. 27, 1996).

wellhead gas market" by ensuring "that all shippers have meaningful access to the pipeline transportation grid so that willing buyers can meet in a competitive, national market to transact the most efficient deals possible."[8]

The Commission's rules requiring open access transportation and unbundling of the commodity sale from the transportation service allowed the development of a free and open wellhead market in gas commodity sales so that a multiplicity of suppliers could flourish by accessing the robust market of consumers. Now gas markets are at the next step where a robust and resilient secondary market for transportation should develop to maximize efficiency and to enable the benefits of competition to accrue directly to all consumers, not principally to large industrial or electric companies. But FERC's assertion of authority over LDC releases of capacity to local retail customers, like its "Special Marketing Programs," favors large out-of-state end-users who do not need firm LDC service and harms the residential, small commercial and other consumers that need firm supplies and pay for the reserved capacity. The capacity release regulation itself thereby undermines the goal of maximizing the consumer benefits of competition and FERC commits the same error found in the *Maryland People's Counsel* cases.

Under state regulation, LDCs also are instituting a variety of unbundled services for retail customers, enhancing the flexibility of end-users of natural gas to access directly gas being sold in competitive markets. LDCs now routinely serve retail customers that choose to purchase gas from alternative gas suppliers by assisting in arranging for pipeline transportation services

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[8] Order No. 636, 57 Fed. Reg. at 13281 (Pet. App. at 234a).

and combining those pipeline services with transportation and delivery services on an LDC's system.[9] In many states, LDCs also are offering services such as storage, balancing and standby gas sales on an unbundled basis.[10]

This Court pointed out in *General Motors*, slip op. at 24, that residential and small commercial customers still rely on transportation, distribution and sales service from LDCs bundled together to meet consumers' basic energy requirements, such as space heating.[11] This Court further emphasized that utilities have an *obligation* under state laws to serve these customers' demand. *Id.* at 17-18 & n. 10. LDCs therefore must contract for a sufficient firm daily supply of gas and pipeline delivery capacity to satisfy potential "peak day" needs of these customers, *i.e.* the higher level demand for gas service that occurs when the weather is coldest, even though average daily needs

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[9] In fact, 81 percent of gas used by industrial customers is purchased from suppliers other than their LDCs, and 25 percent of gas used by commercial customers is purchased from alternative suppliers. Dep't of Energy, Energy Info. Admin., Natural Gas Monthly, Table 24 "Percentage of Total Deliveries Represented by Onsystem Sales, by State, 1994-1995," Jan. 1997 at 64.

[10] *See generally* American Gas Association, "Gas Distribution Industry Pricing Strategies 1995 Update," (FA95-2, Dec. 1995); American Gas Association, "Providing Unbundled Services to Small Volume Customers: Issues to Consider in the Implementation Process," (IB 1996-02, January 5, 1996); American Gas Association, "Providing New Services to Residential Customers: A Summary of Pilot Programs and Unbundling Initiatives," (IB 1996-11, 11A, 11B, 1996).

[11] In addition, certain large customers, such as some apartment buildings, hospitals, industrial plants, etc. continue to prefer firm LDC service.

typically are substantially lower than the potential peak day.[12]

FERC regulates pipeline rates for firm capacity, *i.e.*, capacity that is not subject to interruption, and generally designs firm rates so that all of the fixed costs of the pipeline facilities and business during the course of the year are recovered in the charges that are prorated and paid monthly by the firm customers regardless of how much gas they require to be delivered through the capacity they have reserved. LDCs' rates recover the costs an LDC must pay a pipeline for reserved capacity along with the costs of local delivery facilities and other expenses they incur to serve their customers. State commissions actively oversee these costs to ensure that LDCs are prudent in managing their resources to provide reliable service without overpaying for gas supplies or using pipelines' transportation capacity in an uneconomic manner.[13]

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[12] In fact a typical residential load factor is only 25%; that is, on an average annual basis, residential customers take only 25% of the gas, or use only 25% of the capacity, that they require on peak and are entitled to take.

[13] *Cf. Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa. Commw. 268, 273-274, 465 A.2d 735, 737-738 (1983) (while states cannot bar regulated utilities from passing through to consumers FERC-approved wholesale rates, states properly review the prudence of LDCs' decisions to incur those costs that are avoidable or discretionary); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 385 (1988)(Brennan, J., dissenting).

C. Including LDCs' Release of Capacity to Local Retail Customers Under FERC's Rule Results in Subsidies to Large Users and Marketers from Consumers That the NGA was Intended to Protect.

Order No. 636 permits LDCs and other holders of firm pipeline capacity to "release" pipeline capacity that currently is not being used to meet customer demand; that is, LDCs may allow third parties to use the capacity when the LDCs are not using it themselves to ship gas.[14] As defined by FERC, capacity release is the "reallocat[ion] [of] unneeded firm capacity" on a permanent or temporary basis.[15]

FERC's rules prescribe a number of cumbersome administrative procedures that not only impede LDCs' ability to use their firm rights to capacity for the benefit of their firm core customers, but also usurp states' efforts to assure the maximum benefit for the LDC customers that need and pay for the firm capacity. First, the capacity must be posted on the pipeline's Electronic Bulletin Board in a certain format and with comprehensive information. Second, the capacity must be sold to the highest bidder at a public

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14 Order No. 636, 57 Fed. Reg. at 13824 (Pet. App. at 245a).

15 *Id.* at 244a.

auction, subject to a rate cap equal to the pipeline's maximum approved monthly tariff rate.[16] The replacement shipper contracts directly with the pipeline, and pays the pipeline for the transportation service. The pipeline then credits the releasing LDC with the revenues from the new shipper. The LDC releasing the capacity remains obligated to the pipeline for the difference between the release price and the contract demand charge.[17]

Gas marketers won 79 percent of the capacity release awards during 1995 and that number is growing.[18] Marketers combine the released capacity with gas supplies and sell a bundled service to end-users that often are located in other states. The result is that the released capacity -- which was reserved for the use and benefit of the LDC's retail customers -- goes to other parties who do not carry the economic cost of reserving that capacity.

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16 FERC created two exceptions to the bidding process: 1) if the capacity release was prearranged at the maximum pipeline tariff rate and 2) if the capacity was released for one month or less. 18 C.F.R. §284.243(e) & (h), Order No. 636-A, 57 Fed. Reg. at 36145-46 (Pet. App. at 481a - 485a). Capacity released under these two exceptions to bidding remains subject to the Commission's rate cap. An LDC retail customer may match the highest bid and win the capacity but this is no remedy to the interference by misplaced federal regulation in state programs to enhance competitive purchase opportunities and efficient capacity allocations in local retail markets.

17 Order No. 636, 57 Fed. Reg. at 13284 (Pet. App. at 246a).

18 *See* Interstate Natural Gas Association of America, "Gas Transportation Through 1995," Issue Analysis, Rept. No. 96-3, Sept. 1996 at 8.

The economic harm to the retail customers caused by FERC's rule does not stop there. During most of the year, including the transition months of Spring and Fall, the average rates for released capacity are significantly below the maximum interstate pipeline tariff rates, and therefore significantly below a ratable share of the cost of providing the transportation service. Over the entire 1995-96 winter heating season, which was colder than normal, rates for released capacity nonetheless were discounted an average of 65 percent below maximum tariff rates.[19] During the non-heating season, April through October, capacity release rates were discounted 83 percent.[20] The economic benefit of these deep discounts often goes to the out-of-state dual fuel large users of natural gas or to the marketers serving them, depending upon market conditions.

FERC's rule perpetrates further economic harm to the retail customers who reserve and pay for firm capacity. During the coldest days of the winter, the market value of the released capacity may exceed the maximum approved tariff rate of the pipeline. FERC's monthly rate cap, however, precludes LDCs from recovering the true market value of the capacity to the detriment of the retail customers. The market value of pipeline capacity can be derived from comparing the price of gas in the production area with the price of gas at a particular city gate in markets that are distant from production. For example, in December 1996, the average spot price for gas purchased in Louisiana, a

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19 Dep't of Energy, Energy Info. Admin., *Natural Gas 1996: Issues and Trends*, December 1996, at 46-47.

20 *Id.*

major supply area, was $3.84 per MMBtu while the average spot price for gas purchased at the New York city gate was $5.22 per MMBtu.[21] The $1.38 difference between the purchase price in Louisiana and the purchase price in New York includes approximately $.24 associated with fuel, and other add-ons that are not part of the value of the transportation. Subtracting these costs leaves $1.14 as the value of the transportation from Louisiana to New York.

Under FERC's rules, however, LDCs may charge no more than the pipeline's maximum tariff rate for released capacity. A typical maximum transportation rate on a major interstate pipeline that extends from Louisiana to New York City is approximately $.31 per MMBtu. Thus the mitigation of the embedded costs paid by the LDCs' sales customers was limited to $.31, while the marketer was able to net an additional $.83 per MMBtu.

Under state law, state regulators are charged with protecting the public interest in energy services at reasonable prices. These matters clearly encompass allocating the value of capacity rights purchased by retail customers -- without interference by FERC regulation. Had FERC not usurped state regulation of capacity reserved for retail sales, the $.83 difference between the maximum tariff rate and the true value of the capacity rights would have been available to mitigate the cost to the in-state customers who paid for the capacity year round if the state so elected. The state could have elected to impose an *annual* revenue cap for released capacity equal to the pipeline's annualized embedded cost rate. State energy policy should govern

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[21] Brent Friedenberg Assocs., Ltd., *U.S. Northeast Natural Gas Market Review*, December 1996, Table C1, at 28.

allocation of the economic benefit, as well as the capacity itself, that was reserved for local retail sales is resold to local retail customers.

A significant percentage of the out-of-state, large dual-fuel users of released capacity are electric generators. Thus FERC's rule results in subsidies from LDC firm gas sales customers to electric generators. A federal regulation that indirectly requires local gas consumers to subsidize costs of generating electricity wreaks havoc with state efforts to avoid cross subsidies among fuels and is a serious encroachment into the state regulatory domain of integrated resource planning. Moreover, to the extent electric generators using released capacity pay below embedded costs for transportation, LDCs are disadvantaged in competing in retail energy markets because retail gas rates must reflect the share of pipeline embedded costs that electric generators are not paying.

D. States Constitutionally Can Regulate Unbundled Retail Transportation Services and the NGA Left That Authority Undisturbed.

This Court emphatically has defended the breadth of states' authority to regulate public utilities' service to local retail customers against efforts to read the Natural Gas Act as diminishing that authority. Paraphrasing *Panhandle*, 332 U.S. 507, the Court in *General Motors* said:

> Congress's purpose in enacting the NGA was to fill the regulatory void. . . the NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any

> way [T]he scheme was one of cooperative action between federal and state agencies. . . and Congress' action . . . was an unequivocal recognition of the vital interests of the states and their people, consumers and industry alike, in the regulation of rates and service." [Citations omitted.]

General Motors, slip op. at 12 (quoting *Panhandle v. Public Service Comm'n,* 370 U.S. at 519-522).

Historically, LDCs' use of pipeline capacity incident to serving their local retail customers has been subject to strict oversight by state regulatory agencies. The sale by LDCs of transportation capacity rights, separate from the sale of natural gas itself, at the retail level does not change the local nature of the overall transaction -- natural gas service to consumers. Local retail gas service involves issues of critical importance to states, such as adequate supplies and reliable delivery capacity so that consumers are not cut off in cold weather, as well as impacts on the local economy. Congress in the NGA has left those issues to the states and the Court below erred in affirming FERC's preemption of state authority.

LDCs should be permitted to release capacity to customers behind the city gate under terms regulated by the states for the benefit of those customers on behalf of which the LDC reserved the firm capacity and is paying the full embedded costs. Congress in the NGA left to state regulation that which the constitution permits states to regulate. The disposition of rights to move gas to local end-user markets is an area of local concern constitutionally within the states' purview.

CONCLUSION

For the reasons stated, A.G.A. and Citizen urge the Court to grant the petitions for a writ of *certiorari* to the D.C. Circuit in Nos. 96-1186, 96-1187, and 96-1188.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATED GAS DISTRIBUTORS, ET AL., PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

AMERICAN PUBLIC GAS ASSOCIATION AND CITIZENS GAS & COKE UTILITY, PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

NEW YORK PUBLIC SERVICE COMMISSION, ET AL., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

BURLINGTON RESOURCES OIL & GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

Order No. 636 of the Federal Energy Regulatory Commission (FERC) requires the unbundling of interstate natural gas transportation service from sales service in order to facilitate competition in the national market for gas at the wellhead and ensure equal access to transportation services. The questions presented are:

1. Whether FERC's jurisdiction over interstate transportation of natural gas under the Natural Gas Act, 15 U.S.C. 717 *et seq.*, supports application to local natural gas distribution companies and municipally owned natural gas companies of FERC regulations governing transfer of rights to capacity on interstate natural gas pipelines.

2. Whether FERC correctly concluded that, pursuant to its program for reallocation of pipeline capacity under long-term transportation contracts, it could not require natural gas pipelines to accept bids lower than the maximum just and reasonable rate for transportation capacity.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1186

ASSOCIATED GAS DISTRIBUTORS, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

No. 96-1187

AMERICAN PUBLIC GAS ASSOCIATION AND CITIZENS GAS AND COKE UTILITY, PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

No. 96-1188

NEW YORK PUBLIC SERVICE COMMISSION, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

No. 96-1189

BURLINGTON RESOURCES OIL & GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-174a)[1] is reported at 88 F.3d 1105. The orders of the Commission are reported in Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Pt. 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,939 (Pet. App. 175a-407a), order on reh'g, Order No. 636-A, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,950 (Pet. App. 408a-812a), order on reh'g, Order No. 636-B, 61 F.E.R.C. (CCH) ¶ 61,272 (Pet. App. 813a-998a), reh'g denied, 62 F.E.R.C. (CCH) ¶ 61,007 (Pet. App. 999a-1000a) (Order No. 636).

JURISDICTION

The judgment of the court of appeals was entered on July 16, 1996. A petition for rehearing was denied on October 29, 1996. Pet. App. 1003a-1004a. The petitions for a writ of certiorari were filed on January 27, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In the rule at issue here, Order No. 636, the Federal Energy Regulatory Commission (FERC or Commission) completed the natural gas deregulatory program it had initiated almost a decade earlier. Order No. 636 mandates the "unbundling" of interstate natural gas sales service from transportation service, requiring that those services be sold separately to

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[1] All references to "Pet. App." are to the appendix to the petition in No. 96-1186.

natural gas purchasers. FERC adopted its mandatory unbundling policy in order to "improve the competitive structure of the natural gas industry to facilitate the operation of a national wellhead market as envisioned by Congress," Pet. App. 229a; to "ensure equality of transportation service between gas sold by pipelines or their affiliates and gas sold by other sellers," *id.* at 234a; and, ultimately, to "provide natural gas consumers with access to an adequate supply of clean and abundant natural gas at reasonable prices," *id.* at 229a. Order No. 636 imposes "capacity-release" requirements that allow holders of firm transportation rights on interstate pipelines to resell those rights under uniform terms. *Id.* at 244a-252a.[2] The order also imposes right-of-first refusal (ROFR) requirements, which allow existing shippers with long-term transportation contracts to retain their rights to pipeline capacity if they agree to match the highest bid for that service from alternative purchasers, up to the maximum cost-based transportation rate for the service approved by the Commission under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.* Pet. App. 671a-692a.

2. In 1985, FERC initiated a deregulatory program designed to encourage the voluntary unbundling of pipeline gas sales from pipeline transportation services. Whereas pipelines had traditionally bought gas at the wellhead and transported it before turning it over to the purchaser, the Commission dramatically

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[2] Transportation is referred to as "firm" when delivery is guaranteed without interruption, as distinguished from "interruptible" transportation, which may be interrupted to accommodate the requirements of firm shippers. See Pet. App. 11a n.10.

changed the natural gas industry by enabling pipelines to offer gas sales and transportation services separately, thereby affording customers the opportunity to purchase gas from one company and hire a separate company's pipeline to transport it. See Pet. App. 10a-15a (discussing background to Order No. 636). To further enhance the efficiency of the natural gas market, the Commission encouraged pipeline customers, through a variety of mechanisms, to sell or release their unwanted firm transportation capacity to other shippers.

The partial unbundling of sales and transportation service that resulted from the voluntary program presented serious inefficiencies in allocation of unused transportation capacity. For example, because bundled firm service had often provided superior reliability, many customers continued to pay reservation fees to retain that service, while in most instances using cheaper interruptible service to transport their wellhead gas. See Pet. App. 15a-16a. The secondary transportation market that resulted from partial unbundling produced such a wide variety of capacity-reallocation arrangements that it became impossible for FERC to monitor those programs adequately in order to "ensure that all allocations are nondiscriminatory"; there were "simply too many potential assignors of capacity" for FERC to assure that capacity was allocated "in a manner consistent with the public convenience and necessity." *Algonquin Gas Transmission Co.*, 59 F.E.R.C. (CCH) ¶ 61,032, at 61,095 (Apr. 8, 1992), reh'g denied, 60 F.E.R.C. (CCH) ¶ 61,113 (Aug. 3, 1992).[3] Accordingly, the Commission

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[3] In the *Algonquin* orders, which were issued as companion orders to Order No. 636, the Commission revoked the certifi-

found that the continued operation of the voluntary capacity reallocation programs it had previously approved "would frustrate the goal of * * * remedy[ing] an unreasonable restraint of trade" and would therefore be "unjust and unreasonable and contrary to the public interest." 59 F.E.R.C. (CCH) ¶ 61,032, at 61,096-61,097.

3. To address the problems that arose from partial, voluntary unbundling, FERC's Order No. 636 mandates the complete unbundling of pipeline sales from transportation service and institutes a number of requirements to achieve a fair and open market for transportation rights, and to prevent undue discrimination. See Pet. App. 15a-18a (summarizing Order No. 636).

FERC established, *inter alia*, a uniform capacity-release rule to ensure that unneeded transportation capacity on interstate pipelines is allocated fairly and efficiently. See Pet. App. 71a-103a, as amended by Pet. App. 1001a-1002a, 244a-252a.[4] Under FERC's rule, any shipper desiring to release firm capacity must notify the affected interstate pipeline. The pipeline must then post the available capacity, along with applicable conditions, on an electronic bulletin board for a reasonable period of time, and assign the capacity to the shipper making the best offer for the capacity, up to the maximum just and reasonable price established by the Commission. *Id.* at 245a-247a. A

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cates of public convenience and necessity it had previously issued for capacity reallocation programs and required instead that pipelines abide by the uniform capacity reallocation program of Order No. 636. Review of those orders was consolidated with review of Order No. 636. Pet. App. 19a & n.20.

[4] FERC's capacity-release rule is codified at 18 C.F.R. 284.243.

shipper releasing firm capacity transportation rights may designate a specific party to receive those rights, but the pipeline must post such a prearrangement on the electronic bulletin board, and the designated party can receive the transfer only if no other party makes a better offer. *Id.* at 244a-247a. If the designated shipper bids at the ceiling rate, however, it automatically receives the transportation rights. *Id.* at 245a.

In addition, FERC recognized that, if the wellhead market for natural gas is to function effectively, transportation should be made equally available to all gas purchasers, regardless of whether the wellhead merchant is affiliated with the pipeline. Pet. App. 234a-235a. The principle of "transportation equality" protects captive customers—*i.e.* those connected to only one pipeline, who typically have long-term contracts—from the pipeline's market power. To implement that principle, Order No. 636 imposes, *inter alia*, a "right-of-first-refusal" (ROFR) process allowing competitive allocation of capacity at the expiration of long-term contracts for pipeline transportation, while protecting customers with expiring contracts who remain dependent upon continued transportation service. See *id.* at 43a-56a.

As a condition of granting pipelines authority, under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to abandon contracts at the end of their terms, FERC required pipelines to institute a ROFR mechanism inviting renewal of any long-term contract if the existing shipper matches the highest offer (up to a maximum just and reasonable rate) from any competing bidder for the transportation capacity. 18 C.F.R.

284.221(d); Pet. App. 668a-673a.[5] FERC reasoned that, in general, "a pipeline's service obligation * * * should be determined, in the first instance, by the contract negotiated by the parties," *id.* at 312a, and pipeline transportation capacity is most efficiently allocated if it is sold to those willing to pay the highest price for the capacity, *id.* at 675a. The Commission recognized, however, that where contracts for longer than one year are involved, existing customers may rely on continued service and require some assurance that their current long-term contracts can be extended.

The Commission concluded that the ROFR mechanism "strikes the appropriate balance between the needs of customers for continued service and the benefits of competition in establishing the terms of service." Pet. App. 325a.

4. The court of appeals upheld in large part FERC's Order No. 636, remanding only issues not relevant here. The court concluded that FERC's plenary jurisdiction over interstate transportation of gas on interstate pipelines gives it the authority to regulate the exchange of interstate transportation capacity. Pet. App. 71a-94a. Uniform capacity-release requirements "operate as a term or condition of pipeline service" that FERC may apply to all parties engaged in such interstate transactions, including parties that otherwise are exempt from FERC jurisdiction as local distribution companies (LDCs)

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[5] A pipeline must also extend a contract if it contains either an evergreen or a rollover clause. Such clauses allow parties to extend their contract for a specified term upon the contract's expiration. See Howard R. Williams, *Manual of Oil & Gas Terms* 406-407, 1083-1084 (8th ed. 1991).

or municipally-owned natural gas distributors (municipals). *Id.* at 80a. The court rejected petitioners' asserted distinction between "rights to" and "rendition of" service, concluding that, "[w]hile the pipeline provides *transportation* only when a party utilizes capacity rights to transport gas, the pipeline provides *transportation services* throughout the capacity release process." *Ibid.* (emphasis in original).

The court also rejected several challenges to the ROFR mechanism. Pet. App. 43a-56a.[6] The court upheld the Commission's conclusion that it could not require pipelines considering existing customers' bids under the ROFR mechanism to accept rates below the maximum just and reasonable rate. *Id.* at 53a-56a. The court also concluded that the Commission had included adequate safeguards in Order No. 636 against pipeline manipulation of bids, that there was no basis upon which to require pipelines to accept bids at less than the approved rate, and that the Commission had provided proper incentives in the ROFR process to encourage pipelines to accept discounted rates. *Ibid.*

ARGUMENT

Petitioners challenge the court of appeals' decision upholding the capacity-release and ROFR requirements of Order No. 636. That decision is consistent with the well established principle that the NGA

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[6] Although the court generally affirmed the Commission's ROFR mechanism, it remanded for further consideration the requirement that, in order to retain their existing pipeline capacity, existing shippers must match bids for terms of up to 20 years duration. Pet. App. 49a-53a. On remand, the Commission shortened the maximum term to five years. Order No. 636-C, 78 F.E.R.C. (CCH) ¶ 61,186 (Feb. 27, 1997).

granted FERC "exclusive jurisdiction 'over the sale and transportation of natural gas in interstate commerce,'" *Northwest Cent. Pipeline Corp.* v. *State Corp. Comm'n*, 489 U.S. 493, 510 (1989), and with the decisions of this and other courts construing that grant of jurisdiction. Further review is not warranted.[7]

1. Petitioners Associated Gas Distributors, et al. (AGD) (No. 96-1186), the New York Public Service Commission, et al. (NYPSC) (No. 96-1188) and the American Public Gas Association, et. al. (APGA) (No. 96-1187) challenge the court's affirmance of the capacity-release requirements in Order No. 636. The court of appeals correctly concluded that FERC's capacity-release program is a legitimate exercise of its plenary jurisdiction under the NGA to regulate the transportation of gas in interstate commerce.

a. There is no merit to petitioners' contentions (96-1186 Pet. 18-24; 96-1188 Pet. 13-16) that the Com-

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[7] Order No. 636 comports with FERC's obligation under the NGA to ensure consumers a supply of gas "at the lowest possible reasonable rate." *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, 360 U.S. 378, 388 (1959). As recent studies demonstrate, consumers have reaped substantial benefits from the Commission's decade-long restructuring of the natural gas industry, of which Order No. 636 represents the "latest step." Pet. App. 6a. Specifically, adjusted for inflation, prices paid by local utilities for gas at the "city gate" dropped by 52% in the last decade, prices paid by residential and commercial customers dropped 32% and 38%, respectively, and prices paid by industrial and electric utility customers fell by approximately 60%. Those figures demonstrate that "open access has placed strong pressures on interstate pipelines to reduce their costs and pass the savings through to their customers." Robert Crandall & Jerry Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry* 10-11 (1997).

mission lacks jurisdiction to apply its capacity-release rules to capacity on interstate pipelines held by LDCs. As the court of appeals concluded, "FERC's capacity release program is a legitimate exercise of its jurisdiction over the interstate transportation of natural gas." Pet. App. 77a. Section 1(b) of the NGA grants the Commission jurisdiction over three distinct aspects of the natural gas industry: (1) "the transportation of natural gas in interstate commerce," (2) "the sale in interstate commerce of natural gas for resale for ultimate public consumption," and (3) "natural-gas companies engaged in such transportation or sale." 15 U.S.C. 717(b); see *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (*LP&L*). As this Court has emphasized, the Commission's transportation jurisdiction is "plenary" and extends to all transactions "except those which Congress has made explicitly subject to regulation by the States." *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 216 (1964). Further, as this Court has repeatedly stressed, the Commission's power extends to regulating transactions that, if left unregulated, could interfere with the achievement of the goals of the NGA. *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 310 (1988); *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. of Mississippi*, 474 U.S. 409, 423-424 (1986); *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529, 538 (1979).

The court of appeals' conclusion that the uniform capacity-release requirements are an appropriate exercise of FERC's jurisdiction over interstate transportation of natural gas (Pet. App. 79a-86a) follows naturally from this Court's rulings that the Commission's transportation jurisdiction extends to, for example, the end-use of the transported gas, see *FPC*

v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 7-8, 22 (1961), interruption of interstate transportation service, see *Panhandle Eastern Pipe Line Co.* v. *FPC*, 332 U.S. 507, 523 (1947), curtailment of gas sales, see *LP&L*, 406 U.S. at 641, financing of interstate pipelines, see *Schneidewind*, 485 U.S. at 306, and gas storage, see *id.* at 295 n.1. The court of appeals' decision is consistent with the decisions of all the other circuits that have addressed challenges to FERC's exercise of its transportation jurisdiction.[8]

Moreover, the court of appeals correctly noted that, "[a]s an entirely separate matter," FERC's jurisdiction over abandonments of service supports its regulation of capacity-release transactions because, "[i]n effect, the pipeline is temporarily abandoning service to the releasing shipper and instituting service to the replacement shipper." Pet. App. 80a. Under Section 7(b) and (c) of the NGA, neither abandonment nor ren-

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[8] Other circuits have unanimously held that FERC's jurisdiction extends broadly to all aspects of transportation, including the "initiation, curtailment, quality, quantity, and termination" of gas deliveries. *National Ass'n of Regulatory Util. Comm'rs* v. *FERC*, 823 F.2d 1377, 1385 (10th Cir. 1987). See, *e.g.*, *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987) (limiting liability for curtailments); *Fort Pierce Util. Auth.* v. *FPC*, 526 F.2d 993, 996-998 (5th Cir. 1976) (curtailment of retail gas sales); *Corning Glass Works* v. *FERC*, 675 F.2d 392, 394-396 (D.C. Cir. 1982) (spreading of costs of liquified natural gas plant built by LDC to service customers within its territory); *Mississippi Pub. Serv. Comm'n* v. *FPC*, 522 F.2d 1345, 1350 (5th Cir. 1975) (compensating end users for losses caused by curtailments), cert. denied, 429 U.S. 870 (1976); *Panhandle E. Pipe Line Co.* v. *FPC*, 232 F.2d 467, 472 (3d Cir.) (control over the functioning of a pipeline's facilities), cert. denied, 352 U.S. 891 (1956).

dition of new service may occur without permission and prior approval of the Commission. 15 U.S.C. 717f(b) and (c).[9]

b. Petitioners incorrectly assert (96-1186 Pet. 18-21; 96-1188 Pet. 14-16) that regulation of LDCs' assignment of transportation capacity rights to gas consumers operating within the LDCs' service areas is tantamount to regulation of local distribution. Capacity-release involves assignment of rights to use firm interstate transportation capacity on high-pressure trunk lines. Those lines are not "local distribution facilities" within the meaning of Section 1(b) of the NGA. See *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 470 (1950). FERC has not in Order No. 636 asserted jurisdiction over any activity occurring behind the city gate after the LDC has received gas from an interstate pipeline. Capacity release does not solely affect LDC capacity assignments to end-users located in local service areas, but enables all firm capacity holders, including LDCs, end-users, and marketers, to deliver gas to any existing, out-of-state delivery point on the interstate pipeline upstream of its city gate or usual delivery point. See Pet. App. 271a, 555a. Deliveries of gas to those out-of-state locations under assigned capacity rights cannot be deemed local distribution of gas, nor can any State

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[9] Petitioner NYPSC asserts (96-1188 Pet. 16), without authority, that the court of appeals erred in concluding that the Commission could regulate partial abandonments of service under Section 7 of the NGA. Petitioner's argument that partial abandonments cannot be regulated would create a serious gap in the Commission's regulatory powers and, in any event, ignores the plain requirement of Section 7(b) that a pipeline may not abandon "*any* service," 15 U.S.C. 717f(b) (emphasis added), without Commission approval.

regulate those out-of-state capacity assignments. See *Mississippi River Transmission Corp.* v. *FERC*, 969 F.2d 1215, 1218 (D.C. Cir. 1992); *Michigan Consol. Gas Co.* v. *FERC*, 883 F.2d 117, 121 (D.C. Cir. 1989), cert. denied, 494 U.S. 1079 (1990).

Even where an LDC assigns its firm capacity on an interstate pipeline to a local end-user, settled precedent makes clear that such a transaction does not constitute local distribution of gas. Indeed, the "local distribution" exception to FERC transportation jurisdiction is "confined to [an LDC's] parcelling out function and (probably) even more narrowly, to parcelling out *accompanied by* retail sales." *Public Utils. Comm'n* v. *FERC*, 900 F.2d 269, 276 (D.C. Cir. 1990). Thus, contrary to petitioners' assertions (96-1186 Pet. 16; 96-1188 Pet. 19-20), the court of appeals' application here of Section 1(b)'s established construction is consistent with the holdings of this Court, *e.g.*, *LP&L*, 406 U.S. at 637-638; *East Ohio*, 338 U.S. at 469-470, and other courts of appeals, *Cascade Natural Gas Corp.* v. *FERC*, 955 F.2d 1412, 1418 (10th Cir. 1992); *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987), and plainly expressed congressional intent, H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937) ("local distribution * * * is made only to consumers *in connection with sales*" (emphasis added; internal quotation marks omitted)).

c. Petitioner AGD incorrectly asserts (96-1186 Pet. 21-24) that FERC has used unbundling to interfere with matters that are traditionally controlled by the States. Petitioner ignores the pivotal fact that States have never regulated the terms and conditions of interstate pipeline transportation. As the District of Columbia Circuit explained in *Public Utils. Comm'n*, 900 F.2d at 276-277:

> In an era when transporters almost invariably bought gas at one end of the pipeline and sold it at the other, gas would normally reach an end user only after a pipeline's retail sale to that user, a transaction unquestionably under the state's control, or after conventional distribution and sale by a local distributor, again clearly subject to state control. * * * Under modern conditions, by contrast, where the end user often owns the gas and uses the pipeline solely for transportation, application of *East Ohio* removes this fulcrum for state power.

See *East Ohio*, 338 U.S. at 469-470; *Cascade Natural*, 955 F.2d at 1421.

Petitioners' contentions (96-1186 Pet. 24-28; 96-1188 Pet. 13-14) that capacity release interferes with state regulation of the LDCs' traditional role as local supplier of natural gas are similarly unfounded. An LDC's use of the capacity-release program is voluntary and is aimed at unused (and presumably unneeded) capacity. See Pet. App. 244a-245a. FERC does not regulate any aspect of the rates for an LDC's retail sale of its system supply or the use of its own facilities; it regulates only the LDC's use of interstate transportation capacity. As the court of appeals observed, Section 1(b) "does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of natural gas." Pet. App. 82a.

Contrary to NYPSC's assertions (96-1188 Pet. 13-14), the uniform capacity-release mechanism is not unfair to end-users who have "paid" for LDC "pipeline capacity" through "state-approved rates." Under Order No. 636, an LDC's customer can guarantee assignment of the LDC's interstate capacity rights by

contracting with the LDC at the FERC-approved, cost-based transportation rate, or at any lower rate that trumps competing offers. Pet. App. 485a. By allowing LDCs to shed unused capacity and thereby lower costs, the capacity-release mechanism benefits consumers.

AGD incorrectly contends (96-1186 Pet. 27-28) that the capacity-release program impairs state efforts to require LDCs to unbundle local transportation service from retail sales. Rather than imposing obstacles, however, FERC's rule facilitates local unbundling by guaranteeing end-users access not only to their own LDCs' released capacity, but also to the capacity released by any other capacity holder who holds rights to a delivery point at or downstream of the LDC's position on the interstate pipeline. See Pet. App. 271a-272a, 495a-497a.[10]

d. AGD also errs in asserting (96-1186 Pet. 14-18) that the Hinshaw Amendment to the NGA, Pub. L. No. 323, 68 Stat. 36, exempts LDCs from the uniform capacity reallocation mechanism. The Hinshaw Amendment exempts from FERC regulation any person engaged in the transportation or sale in inter-

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[10] AGD argues (96-1186 Pet. 27) that Order No. 636 interferes with "blended" capacity programs now being offered by the States. That argument was neither raised before nor addressed by the Commission or the court of appeals, and there is no factual basis in the record to support it. That claim therefore is not properly presented to this Court. See 15 U.S.C. 717r(b) ("No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing."); see also *Sullivan* v. *Louisiana*, 508 U.S. 275, 279 n.1 (1993) (stating that this Court does not ordinarily review issues not raised below).

state commerce of natural gas received "within or at the boundary of a State" and "ultimately consumed within such State." 15 U.S.C. 717(c). Congress enacted the Hinshaw Amendment "to preserve state control over local distributors who purchase gas from interstate pipelines * * * [but] Congress did not intend the amendment to relieve the Commission of jurisdiction over * * * integrated interstate systems." *Louisiana Power & Light Co.* v. *FPC*, 483 F.2d 623, 633 (5th Cir. 1973), cert. denied, 416 U.S. 974 (1974). As the court of appeals explained, "the Commission's authority to regulate capacity release arises from its jurisdiction over the interstate pipeline that consummates the transaction and the subject of the transaction, the interstate transportation of gas, entirely independent of its jurisdiction over the releasing or replacement shippers." Pet. App. 82a n.62. Moreover, in order for the Hinshaw Amendment to apply, the service at issue would have to be subject to effective state regulation. The States cannot effectively regulate the transactions at issue here because they cannot prevent interstate pipelines from discriminating in favor of in-state users at the expense of out-of-state users. The Hinshaw Amendment accordingly has no application to the interstate transactions at issue here.

AGD places great weight on its contention (96-1186 Pet. 17) that the Hinshaw Amendment overruled this Court's decision in *East Ohio*, 338 U.S. at 461. Although *East Ohio*'s holding—that FERC had jurisdiction over an interstate gas pipeline operating in only one State—is no longer the law, the Hinshaw Amendment did not affect the Court's analysis in *East Ohio* of the scope of the Commission's jurisdiction over pipelines that transport gas across state lines. See

Altamont Gas Transmission Co. v. *FERC*, 92 F.3d 1239, 1246 (D.C. Cir. 1996), petition for certiorari pending, No. 96-1179 (filed Feb. 11, 1997); *Public Utils. Comm'n*, 900 F.2d at 275 n.4. Notwithstanding the particular change brought about by the Hinshaw Amendment, this Court and the courts of appeals have continued consistently to rely on *East Ohio* as a correct and otherwise still valid interpretation of the NGA. *E.g.*, *LP&L*, 406 U.S. at 636-637 & n.13; *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965); *Cascade Natural*, 955 F.2d at 1416-1421; *Public Utils. Comm'n*, 900 F.2d at 275.

e. APGA similarly contends (96-1187 Pet. 9-11) that the court of appeals erred in concluding that municipally owned gas companies must comply with the uniform capacity reallocation mechanism when they seek to reassign interstate pipeline capacity. APGA reasons that, because Section 2 of the NGA excludes municipals from the definition of "persons" regulated as "natural gas companies" under the Act, 15 U.S.C. 717a(1)-(3) and (6), FERC may not require that they comply with the terms of FERC's capacity-release program. 96-1187 Pet. 7-8. The court of appeals correctly concluded, however, that "FERC may, consistent with the NGA, require municipalities to comply with its capacity release regulations" because "FERC's transportation jurisdiction extends as a separate matter over capacity release * * * entirely independent of the jurisdictional nature of the releasing and replacement shippers." Pet. App. 84a-85a.

Although FERC lacks jurisdiction to regulate municipals as such, the Commission's jurisdiction over interstate transportation is not limited to natural-gas companies or "persons" engaged in transportation.

Instead, it extends to all interstate transportation of gas, regardless of the parties involved in such transportation. This Court has rejected the contention "that the word 'transportation' in § 1(b) must be construed as applying only to companies engaged in the business of transporting gas in interstate commerce," concluding that "the Act's language did not express any such limitation." *East Ohio*, 338 U.S. at 468. Indeed, the courts have long recognized that municipalities, although not "natural-gas companies" or "persons" under the Act, are nonetheless subject to NGA regulation under those NGA provisions that are not exclusively directed at "natural-gas companies." See, *e.g.*, *California* v. *Southland Royalty Co.*, 436 U.S. 519, 528 (1978); *Public Serv. Co.* v. *FERC*, 587 F.2d 716, 719 (D.C. Cir. 1979). Thus, as the court of appeals observed (Pet. App. 85a), this Court has concluded that the Commission may properly regulate the curtailments of both gas supply and capacity to municipals under its transportation jurisdiction, see *Transcontinental Gas*, 365 U.S. at 20-22; *LP&L*, 406 U.S. at 640—a situation involving allocation of transportation capacity among shippers in compliance with federal mandates that is "strikingly similar" to capacity release. Pet. App. 85a.[11]

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[11] APGA argues (96-1188 Pet. 13-14) that there is a distinction between transactions in the primary and secondary market for pipeline capacity. As we have noted, pages 10-11, *supra*, however, the Commission's jurisdiction over transportation extends to all aspects of interstate pipeline operation. Further, to declare such secondary transactions beyond the Commission's jurisdiction would create an anomalous gap in the comprehensive regulation intended by Congress in enacting the NGA. See *LP&L*, 406 U.S. at 631-632.

APGA further contends (96-1187 Pet. 12-19) that FERC's regulation of municipalities under its transportation jurisdiction conflicts with FERC's own policy established in *Texas Eastern Transmission Corp.*, 51 F.E.R.C. (CCH) ¶ 61,170 (May 11, 1990). The court of appeals correctly rejected that contention. Pet. App. 84a & n.64. In *Texas Eastern*, the Commission authorized firm transportation customers of an interstate pipeline to broker capacity to third parties without the involvement of the carrying pipeline itself. The Commission required such customers to obtain "limited jurisdiction" certificates under Section 7(c) of the NGA because, as brokers, they were within the meaning of NGA Section 1(b). The Commission, however, ruled that municipals were exempt transporting gas from any such certification requirement because they were not "natural gas companies" and therefore not subject to Section 7. See 48 F.E.R.C. (CCH) ¶ 61,248, at 61,873-61,875 (Aug. 22, 1989); 51 F.E.R.C. (CCH) ¶ 61,170, at 61,453-61,454. The capacity brokering arrangements in *Texas Eastern* were performed by capacity holders themselves without pipeline involvement; under Order No. 636, in contrast, FERC regulates capacity assignment by pipelines. The court of appeals thus correctly held that the *Texas Eastern* approach is inapplicable, and that FERC may require municipals' compliance with capacity-release rules as it may require their compliance with other pipeline terms or conditions of interstate transportation service. Pet. App. 84a-85a.[12]

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[12] *Texas Gas Transmission Corp.*, 55 F.E.R.C. (CCH) ¶ 61,208 (May 13, 1991), and *United Gas Pipe Line Co.*, 46 F.E.R.C. (CCH) ¶ 61,060 (Jan. 24, 1989), modified on other grounds, 49 F.E.R.C. (CCH) ¶ 61,166 (Nov. 7, 1989), followed

Finally, there is no merit to APGA's assertion (96-1187 Pet. 19-20) that the Commission's capacity-release mechanism is merely a sham designed to expand its jurisdiction. As the court of appeals observed, under Order No. 636, "[t]he pipelines' role in capacity release is absolutely central, and the transaction itself controls access to interstate transportation capacity." Pet. App. 84a-85a (footnote omitted). Order No. 636 requires pipelines to maintain electronic bulletin boards upon which proposed transactions are posted, administer the rules for operation of the bidding system, and select the successful bidder. In short, as the court observed, capacity release necessarily involves movement of gas in interstate commerce by the assignee of capacity rights because "[b]y controlling such capacity, the assignors are effectively determining by whom, and under what circumstances, gas will be transported and are using the pipeline's facilities as if they were the assignors' facilities." *Id.* at 81a.

2. Petitioner Burlington Resources Oil & Gas Company (Burlington) (No. 96-1189) argues that the court of appeals erred in affirming FERC's conclusion that pipelines allocating long-term transportation rights under the ROFR mechanism do not have to accept bids at less than the maximum, cost-based just and reasonable rate established by the Commission under the NGA. Burlington asserts (96-1189 Pet. 7-9) that the ROFR rule violates the Commission's obligation under the NGA to protect consumers. As the court of appeals concluded, however, "the basic structure of the [ROFR] mechanism provides

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the *Texas Eastern* approach, and APGA's reliance on those decisions (96-1186 Pet. 14) similarly fails to support the petition.

the [customer] protections from pipeline market power required for pre-granted abandonment under [NGA] § 7." Pet. App. 49a; see also *id.* at 54a-55a. The ROFR procedure "guarantees that existing customers may have continued service," and "affords protection to the existing customer against *any* exercise of monopoly power," *id.* at 933a (emphasis added), because the customer will be required to pay, at most, the cost-based just and reasonable rate established by the Commission in a ratemaking proceeding, *id.* at 679a. As the court of appeals observed, the NGA "protect[s] customers against loss of service only if the customer is willing to pay the maximum rate approved in a rate proceeding." *Id.* at 55a. The Commission concluded that the ROFR mechanism "provides more than adequate protection that pipelines will not be able to charge monopoly rates for their service." *Id.* at 672a. This Court approved a very similar pricing mechanism in *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 498 U.S. 211 (1991) (upholding FERC rule setting maximum "just and reasonable" rate for gas sold under Natural Gas Policy Act price ceilings, but allowing sellers voluntarily to accept lower prices if market conditions dictate).[13]

Contrary to Burlington's assertions (96-1189 Pet. 11-12), FERC's decision to leave to pipelines' discretion whether to accept below-ceiling bids voluntarily does not encourage anti-competitive behavior. The

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[13] If a pipeline elects to leave capacity idle rather than accept a below-ceiling bid for that capacity, the shipper may also file a petition with the Commission under Section 5 of the NGA claiming that the pipeline's action is "unjust, unreasonable, unduly discriminatory, or preferential." 15 U.S.C. 717d(a).

Commission cannot require a pipeline to accept rates below the cost-based just and reasonable rate ceiling under the Commission's ROFR program. Those rates are, by definition, the lowest rates that ensure pipelines an adequate return on their investment; requiring pipelines to accept a lower rate would put them at risk of under-recovery in violation of the Commission's duty to ensure pipelines sufficient returns and adequate capitalization. See *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (rates must "assure confidence in the financial integrity" of the regulated entity "so as to maintain its credit and attract capital"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) (rates must "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests"); *Associated Gas Distribs.* v. *FERC*, 824 F.2d 981, 1007-1013 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988).

Burlington also errs in arguing (96-1189 Pet. 12-15) that FERC should have imposed a rate within the zone of approved rates, but below the maximum just and reasonable rate. Burlington relies chiefly on *Associated Gas*. The pricing mechanism approved in *Associated Gas* established a cost-based just and reasonable rate, but allowed pipelines to "consent to selective discounting" down to prescribed minima. 824 F.2d at 1010. That voluntary discounting approach is precisely the approach taken here.[14]

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[14] Burlington misconstrues cases holding that FERC may establish rates within a "zone of reasonableness." See 96-1189 Pet. 14. That test applies to judicial review of the Commission's rates, not to the establishment of those rates in the first

Finally, Burlington errs in asserting (96-1189 Pet. 18-20) that FERC failed to provide a rationale for its decision not to require pipelines to accept discounted rates under the ROFR process, and that the court of appeals supplied its own rationale. The Commission's statement that pipelines "are not required to accept any offer at less than the maximum rate," Pet. App. 673a, correctly reflects existing law on that point. See page 22, *supra*. Each of the rationales relied upon by the court of appeals was also articulated in the Commission's orders. See Pet. App. 671a-673a, 935a-937a. In any event, a reviewing court retains the power to identify the proper construction of the governing law, even if not argued by the Commission. *Arcadia* v. *Ohio Power Co.*, 498 U.S. 73, 77 (1990).

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instance. See *Permian Basin*, 390 U.S. at 767. Burlington also asserts (96-1189 Pet. 16) that the NGA does not guarantee pipelines cost recovery, but only affords them the opportunity to recover their costs. That opportunity, however, must include the possibility of recovering adequate returns on capital investment, which, by definition, turns on the cost-based rate established by the Commission.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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On Petition for a Writ of Certiorari to the
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for the District of Columbia Circuit

REPLY OF PETITIONERS PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, ET AL.

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REPLY OF PETITIONERS PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, ET AL. ("PSC" Petitioners")

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1. Although replies are to address "new points raised," Rule 15.6 of this Court's Rules, the most telling aspect of the briefs in opposition[1] is their studied indifference to *General Motors Corp. v. Tracy, Tax Comm'r of Ohio,* No. 95-1232 (U.S. Feb. 18, 1997). FERC completely ignores the case and PGC buries it. PGC Br. 2 and 15.

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[1] Briefs in opposition were filed by the Federal Energy Regulatory Commission ("FERC") and by the Process Gas Consumers Group, *et al.* ("PGC"). Those briefs will be referred to herein as "FERC Br." and "PGC Br.," respectively.

At bottom, the instant petition concerns whether States or FERC should oversee one aspect (release of LDC-owned pipeline capacity) of FERC's unbundling plan as it affects LDC customers. The *Tracy* decision analyzed the historical development of natural gas regulation, including dual jurisdiction under the Natural Gas Act ("NGA"), in the context of a continuing need for traditional regulation to protect small customers. *See generally, Tracy*, slip op. at 13-19. That analysis bears directly on the jurisdictional issue raised in the instant matter.

2. *Tracy* reaffirmed use of two tenets to guide evaluation of when state, rather than federal, regulation should apply to natural gas transactions. One tenet recognizes that federal authority under the NGA is designed to complement, not to override, state authority to protect consumers in matters of local concern:

> [T]he NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way,"; "the scheme was one of cooperative action between federal and state agencies" to "protect consumers against exploitation at the hands of natural gas companies,"; and "Congress' action . . . was an unequivocal recognition of the vital interests of the states and their people, consumers and industry alike, in the regulation of rates and service."

Slip op. at 12 (citations omitted).

FERC and PGC ignore this well-established tenet in asserting the primacy of federal authority in any matter involving interstate transportation. FERC contends its "transportation jurisdiction is 'plenary' and extends to all transactions 'except those which Congress has made explicitly subject to regulation by the States.'" FERC Br. at 10 (citation omitted);

see PGC Br. at 13-14 (same). Because virtually all natural gas transactions (other than those where production and consumption occur in the same state) include an interstate transportation component, this reading of the NGA would result in FERC control of the entire industry.

Such intrusive federal authority was not intended under the NGA. Rather, the opposite is true: " 'the [NGA's] historical setting, legislative history and objects [] show [an] intention for the states to continue with regulation where Congress has not expressly taken over.' " *Tracy*, slip op. at 13 (citation omitted). Nor is FERC's jurisdiction over interstate transportation intended to usurp States' long-standing authority to regulate transactions between local distribution companies ("LDCs") and their customers. *See id.* ("Congress amended the NGA to 'leav[e] jurisdiction' over 'companies engaged in the distribution' of natural gas 'exclusively in the States, as always has been intended.' ") (citation omitted).

3. The importance of preserving States' authority over local concerns affecting small consumers is a second tenet to be evaluated in determining whether state, rather than federal, regulation should apply. "Regulation of natural gas for the principal benefit of householders and other consumers of relatively small quantities is the rule in every State in the Union. Congress has also long recognized the desirability of these state regulatory schemes." *Tracy*, slip op. at 26.

FERC and PGC contend that local concerns can be overridden by an overarching need for uniform, national regulation. See PGC Br. at 17 ("state regulation, even if nominally within a regulatory sphere reserved to the states by the NGA, must yield to FERC's jurisdiction if such state regulation would hinder or frustrate FERC's efforts to achieve comprehensive, uniform regulation of interstate transportation"); and FERC Br. 7 (same). Protection of consumers, not unformity of

regulation, is, however, the primary goal of the NGA. Protection of residential and small commercial consumers is best accomplished at the State level where local concerns can be fully addressed.

4. Giving states primary authority to protect local consumer interests neither denigrates nor frustrates legitimate federal concerns. Those concerns can be safeguarded by instituting broad national policies within which states have flexibility to address local concerns. FERC's earlier capacity release plan, superseded by the plan under review, engrafted broad "open-access" policies to interstate pipeline tariffs, but allowed private parties to adjust contract terms to fit specific needs, subject to State regulation. In contrast, the present plan imposes the federal will on all capacity release by LDCs without regard to local concerns affecting small customers.

Federal policies should be loathe to displace traditional state regulation, which can offer residential and small commercial customers access to competitively-priced, in-state gas or other benefits. "The size of the captive market, its noncompetitive character, the values served by its traditional regulation: all counsel caution before making a choice that could strain the capacity of the States to continue to demand the regulatory benefits that have served the home market of low-volume users since natural gas became readily available." *Tracy*, slip op. at 29.

5. PSC Petitioners present the issue of whether FERC or the States should control release of LDC pipeline capacity to LDC custome. FERC's decision that it, not the States, should control such release could eviscerate States' ability to demand that the regulatory benefits flowing from LDC capacity release go to low-volume customers who have paid, through their rates, the costs of construction and operation of that capacity.

FERC's program does not acknowledge the need for a benefit offsetting this burden. Rather, the plan mandates that capacity be released to the highest bidder (up to a ceiling rate), regardless of whether a bidder is a customer of the releasing LDC. FERC contends that this process "is not unfair to end-users who have 'paid'" for capacity because they can get released capacity "by contracting with the LDC at the FERC-approved, cost-based transportation rate, or at any lower rate that trumps competing offers." *Id.* at 14-15. In other words, a customer must pay the maximum rate or otherwise outbid all others. This result merely puts LDC customers in the same position as any other bidder, including those who have borne none of the costs of that capacity.

The imbalance between the burdens and benefits caused by FERC's plan is neither theoretical nor slight. As the amicus brief of American Gas Association and Citizen Action ("AGA Br.") points out, gas marketers, who shouldered none of the burdens, nonetheless obtained nearly 80% of all 1995 capacity release awards. AGA Br. 15. Moreover, the winning bids were at discounts ranging from 65% to 83% of the ceiling rates. *Id.* at 16. These discounts result in low-volume customers further subsidizing releases because under FERC's plan releasing LDCs, not the winning bidder, must make up the differential between the winning bid and the ceiling rate.

In sum, low-volume customers bear all the burdens of the capacity being released, but receive little, if any, benefit.

6. Respondents assert that "FERC's jurisdiction over the interstate transportation of natural gas *is wholly unrelated to the nature of the entities involved in that activity.*" PGC Br. at 16 (emphasis in original); *see* FERC Br. at 14 (petitioners' arguments "that capacity release interferes with state regulation of the LDCs' traditional role as local supplier of natural gas are similarly unfounded").

Differences in the entities involved are properly considered in deciding whether state or federal regulation would better promote the public interest. This is particularly true today where the differences between those who have the ability take advantage of unbundling and open access initiatives and those who do not, require different regulatory responses:

> The upshot of congressional and regulatory developments over the next 15 years was increasing opportunity for a consumer in that class to choose between gas sold by marketers and gas bundled with rights and benefits mandated by state regulators as sold by LDCs. But amidst such changes, two things remained the same throughout the period involved in this case. Congress did nothing to limit the States' traditional autonomy to authorize and regulate local gas franchises, and the local franchised utilities (though no longer guaranteed monopolies as to all natural gas demand) continued to provide bundled gas to the vast majority of consumers who had neither the capacity to buy on the interstate market nor the resilience to forgo the reliability and protection that state regulation provided.

Tracy, slip op. at 14.

These considerations apply to the regulation of LDC capacity release to LDC customers. FERC's program offers, at best, minimal benefits to residential and small commercial users, who are largely incapable of availing themselves of the bidding process, but who have incurred burdens related to the capacity. Determining the extent of that burden and the appropriate countervailing benefit are largely matters of local concern. Matters of local concern fall within State, not federal, jurisdiction.

7. FERC argues that the PSC Petitioners claimed that "the Commission could [not] regulate partial abandonments of service under Section 7 of the NGA." FERC Br. 12 n. 9. This misstates the PSC Petitioners' position: FERC obviously has jurisdiction to regulate partial and full abandonments. Rather, the position is that capacity release cannot be equated with partial abandonment.

Abandonment implies cessation of service. Service does not cease in the case of released capacity.[2] LDCs continue to pay all tariff charges for the capacity during the term of release (and are credited with payments received). Continued LDC payments do not signal cessation of service. Likewise, LDCs' use of this capacity in non-release periods does not show an intent to cease service.

The point is that capacity release does not have the necessary indicia of abandonment, not that FERC lacks power to regulate abandonment. Calling capacity release a partial abandonment is merely a convenient fiction to disguise FERC's usurpation of state authority.

8. PGC contends that the PSC Petitioners "distort[] the meaning of" *Texas Eastern Transmission Corp.*, 48 FERC ¶61,378 at 62,552 (1989). PGC Br. 4 n. 9. But the meaning ascribed by PGC — "that FERC acknowledged state jurisdiction over interstate capacity held by LDCs," *id.* — goes beyond that ascribed by PSC Petitioners.

PSC Petitioners view *Texas Eastern* as making the limited points (a) that a purchaser of pipeline capacity (not the pipe-

[2] Because pipeline capacity is designed to meet peak period use of the facilities, some portion of that capacity will be idle during non-peak periods when smaller volumes of natural gas move through the facilities. It has never been suggested that such idle capacity (i.e., the capacity being released under FERC's plan) is abandoned within the meaning of Section 7(b) of the NGA.

line) is considered the owner of that capacity and (b) that such capacity is considered an extension of the purchaser's delivery system. Recognizing the purchaser's rights "allow[s] the customers to step into the shoes of the [purchaser] to obtain a service comparable to, but no greater than, the rights of the [purchaser]" of that capacity. *Texas Eastern*, 48 FERC at p. 62,552. FERC's capacity release plan violates these rights by assuming capacity being released is owned by pipelines, and thus is subject to FERC jurisdiction, rather than recognizing that LDCs hold the capacity rights, subject to state regulation.

CONCLUSION

The petition for issuance of a writ of certiorari should be granted.

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